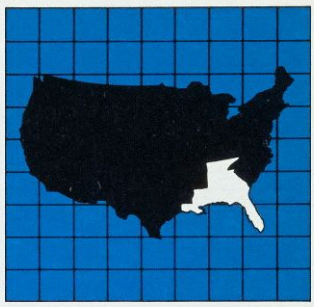
Binding

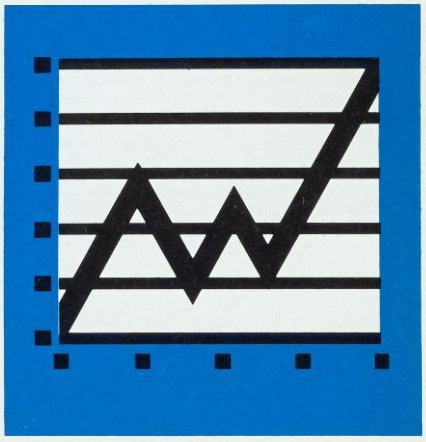
# Economic Review



FEDERAL RESERVE BANK OF ATLANTA DECEMBER 1982







Economic Review

FEDERAL RESERVE BANK OF ATLANTA

# The Risks of Creative Financing

**More than half the home sales in a recent survey involved creative financing. While creative financing may keep the selling price high, it also can leave the seller holding the mortgage—or the bag.**

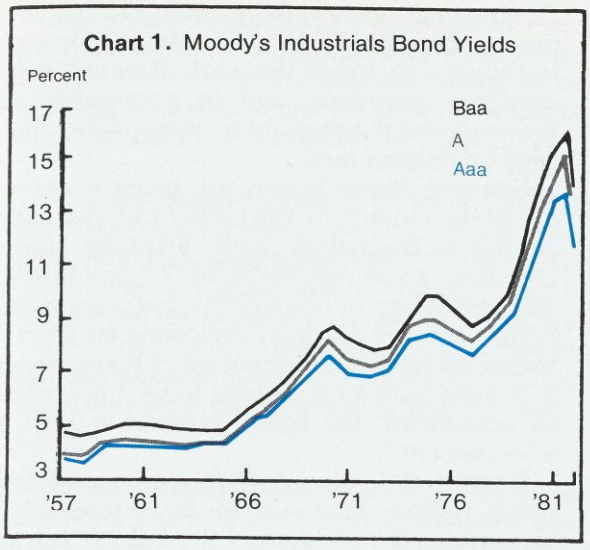

As mortgage rates soared in the past several years, realtors, developers, builders, home sellers, and home buyers looked for sources of funds other than traditional lending institutions. Today, the residential real estate market is focusing on "creative financing" techniques, which involve a supplier of funds in addition to or in place of a financial institution. Over half of the home sales we looked at in a recent survey of southeastern realtors involved creative financing. In 41 percent of the sales we surveyed, the seller had taken back either a first, second, or third mortgage.[1]

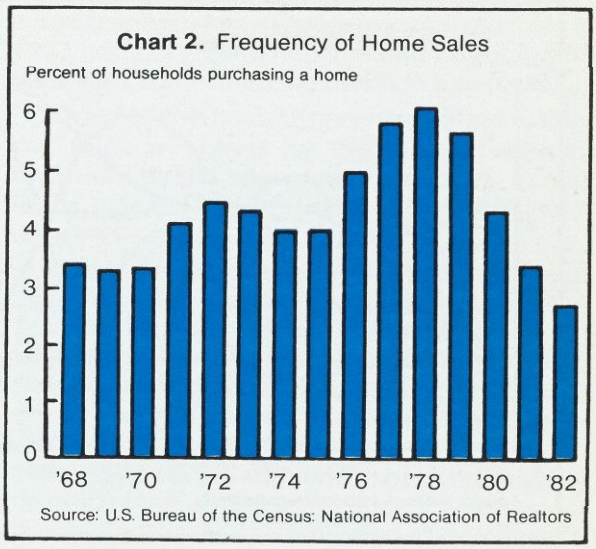
Our survey indicates that sellers and their realtors often ignore the less risky alternatives available to them in closing a sale in favor of maximizing the sales price. Individual mortgage holders do little credit analysis in extending loans. In a substantial number of cases, the total mortgage on a home is greater than its true market value. Judging from the realtors' experience, home prices in the Southeast are advancing slowly, homes are remaining on the market for longer periods than they did three years ago, and buyers are paying a premium (over market value) sales price to obtain "below market" mortgage rates.

Creative financing is an intermediate response to a structurally changing industry. The recent stagnation in the traditional financial markets left a gap that is being filled by an innovative, non-traditional mechanism. The basic problem with creative financing, however, is that the sellers, in providing financing, often seem more intent on consummating a sale than on making a sound investment with a positive real rate of return. For this reason, many fundamental principles of lending are ignored when the deals are constructed.

Financial institutions analyze their loans on the basis of the risk involved and the expected rate of return. Unsecured consumer credit generally will carry a higher rate of interest than a secured automobile loan. Likewise, the rates on small business loans usually are higher than the prime interest rate, granted only to the most financially secure companies. The risk premium reflected in interest rates also appears in the yields on industrial bonds of differing

[1]The Federal Reserve Bank of Atlanta sponsored a survey of realtors in eight southeastern cities in July, 1982 which was conducted by the Georgia State University Department of Economics. From responses of 80 realtors, we drew information about 333 specific sales closed in 1982. The survey is a follow-up to the one conducted by the Federal Reserve Bank of Atlanta in first quarter, 1981. See the October 1981 issue of the **Economic Review** for the results of that survey.




quality. Bonds with a low quality rating of Baa have consistently yielded more than bonds with a high quality rating of Aaa[2] (Chart 1).

Many people involved in arranging creative financing are untrained and inexperienced in the analysis of risk or return on investment. Some obvious contradictions occur when a seller accepts a 12 percent return on a second mortgage based on the same risk for which a lending institution would require an 18 percent return, or if a seller accepts a 12 percent return on a five-year balloon note when he could invest the funds in a five-year Treasury note at 14 percent.[3] A thorough understanding of the risks involved and the less risky alternative means of financing would encourage home buyers and sellers to scrutinize their creative financing arrangements more carefully.

## Why Use Creative Financing?

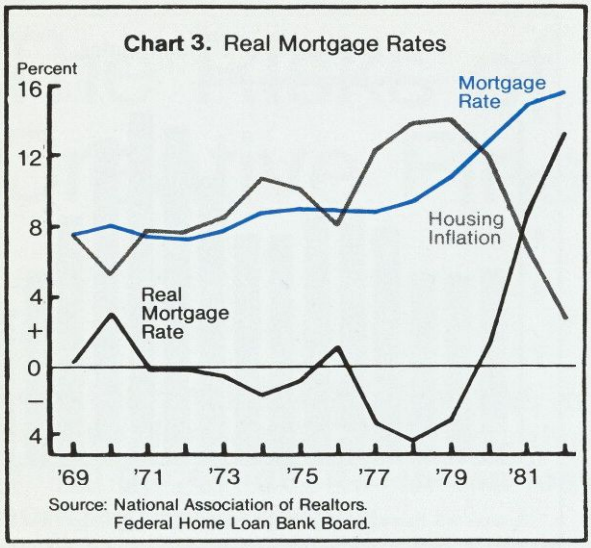
The real estate market remains in a severe slump. From 1978 to 1982, existing home sales declined 54 percent and housing starts dropped 60 percent. The southeastern real estate market is no exception. As of July, new housing construction had declined below the late 1970s peak by 58 percent in Alabama, 48 percent in Florida, 29 percent in Georgia, 53 percent in Louisiana, 57 percent in Mississippi, and 61 percent in Tennessee.[4]

The severity of the downturn is depicted in Chart 2. During the late 1960s, the percentage of all U. S. households purchasing a new or existing home was stable at just over 3 percent. The decade of the 1970s brought a real estate boom as a greater percentage of households

[2]Paul Samuelson explains the determination of interest rates as follows: "The market rate of interest is that percentage return per year which has to be paid on any safe loan, bond or other type of security, and which has to be earned on the value of any capital asset (such as a machine, a hotel building, a patent right) in any competitive market where there are no risks or *where all risk factors have already been taken care of by special premium payments to protect against risk.*" The risk factor must be quantified in order to incorporate it into the interest rate. In **Essentials of Managerial Finance** J. Fred Weston and Eugene F. Brigham describe the traditional measure of risk as follows: "The riskiness of an asset is defined in terms of the likely variability of future returns from the asset. The tighter the probability distribution of expected future returns, the smaller the risk of a given project." Moody's describes its bond ratings: "Bonds which are rated **Aaa** are judged to be of the best quality. They carry the smallest degree of investment risk and are generally referred to as 'gilt edge.' Interest payments are protected by a large or by an exceptionally stable margin and principal is secure. While the various protective elements are likely to change, such changes as can be visualized are most unlikely to impair the fundamentally strong position of such issues. Bonds which are rated **Baa** are considered as medium grade obligations, i.e., they are neither highly protected nor poorly secured. Interest payments and principal security appeared adequate for the present but certain protective elements may be lacking or may be characteristically unreliable over any great length of time. Such bonds lack outstanding investment characteristics and in fact have speculative characteristics as well."

[3]In the first half of 1982, financial institutions charged an average 18 percent on second mortgages, five-year Treasury notes yielded an average 14.22 percent, and sellers charged an average 12 percent interest rate on second mortgages.

[4]Nationwide existing home sales reported by the National Association of Realtors and housing starts by the U.S. Bureau of the Census. New housing construction for southeastern states is reported in F.W. Dodge Construction Potentials.




began to buy a home each year. Interestingly, the 1973-75 recession resulted in only a short pause in the growth trend of home purchases. Even though that recession was considered rather severe for the real estate industry, the percent of households purchasing homes in 1974 and 1975 was greater than in the late 1960s. The real estate boom of the 1970s peaked in 1978 when 6.2 percent of all households bought a home. The decline in home sales since 1978 has been severe. This year only 2.7 percent of all households have purchased a home. Had creative financing not existed, it is likely that this percentage would have been even smaller.[5]

The reduced activity is primarily a function of high rates on new mortgages. When inflation in home prices was higher than mortgage rates, the real cost to the consumer of financing a home was negative. Today, the large positive differential between mortgage rates and housing appreciation has dampened consumers' ability and motivation to buy a home (Chart 3). Home buyers simply cannot afford payments implied by the current high level of mortgage rates. Double-digit rates make it more difficult for a borrower to qualify for a loan from a financial institution, to meet the cash flow of higher mortgage payments, and to accumulate the down payment necessary to meet higher mortgage origination fees.

First-time home buyers are being squeezed out of the market. In 1981, only 13.5 percent of all home purchasers were first-time buyers compared to 36 percent in 1977.[6] And in 1981 the percentage of households that owned their homes actually declined. Following 40 years of prosperity when the percentage of home owners increased from 43.6 percent to 64.4 percent of all households, the figure dropped in 1981 to 63.6 percent.[7]

Despite the rising cost of owning a home, many people continue to be interested in ownership. The children of the baby boom are now in their early 20s to early 30s. Many have delayed marriage and family and are just now beginning the search for their first homes. They grew up in single-family suburban homes and want the same or better for their families. Mobile families expect to be able to change jobs and buy a home anywhere in the country virtually at will. Additionally, people have come to believe that housing is the best investment they can make based on rapidly rising home values and the income tax deductions allowed for interest expense and property tax payments.

While these trends are beginning to be reversed, potential home buyers' expectations have motivated them to search for affordable housing and have encouraged sellers to find means of providing affordable housing. To bring the cost of housing within reach, buyers and sellers have compromised on financing techniques rather than on price. The reasons for this choice appear to be the realtors' desire to preserve sales price and the sellers' preoccupation with the appreciated value of their homes.

## Risks of Creative Financing

Creative financing might be less popular today if buyers and sellers were aware of all the risks involved. The risks are of three types:

[5]The total number of home purchasers is derived by adding the total number of existing homes sold (National Association of Realtors) plus the number of new homes sold (U.S. Bureau of the Census). The total number of home purchasers divided by the total number of households (U.S. Bureau of the Census) gives the percentage of households purchasing a home. There may be a slight upward bias in this calculation owing to multiple purchases by individual households and an upward bias in NAR reporting of sales.

[6]U.S. League of Savings Associations.
[7]U.S. Bureau of the Census.

(1) **Economic Environment**—Many creative loans are made with the assumption that resale values will continue to climb and that refinancing will be available in several years. Yet growing evidence suggests that this assumption may be faulty.

(2) **Loan quality**—Lenders generally analyze the risk associated with a loan according to three primary factors, sometimes referred to as the C's of lending: a. Capital base of the borrower, b. Capacity of the borrower to repay the debt, and c. Character of the borrower. Seller-financers sometimes fail to take these factors into account when they set a mortgage rate or agree to extend a loan.

(3) **Institutional**—Most creative arrangements involve a financial institution as well as a third party lender. The institutions are threatened by creative arrangements which attempt to circumvent their mortgages' due-on-sale clauses. Also, creative financing may overextend the buyer's total debt burden, making default on institutional-held mortgages more likely in a recessionary environment.

## ● Environmental Risks

The following statement from the National Association of Realtors' Real Estate Status Report, as recently as April 1982, seems to typify the creative financing "mentality." "Mortgage interest rates .... will not come down very much over the foreseeable future," it declares. "And while people wait for lower mortgage rates, home prices will be increasing. The result: Any anticipated savings in interest payments will be more than offset by the expected increase in home prices. Without doubt, delays in home buying will prove costly."

Recently, however, housing prices have been leveling off. According to the National Association of Realtors, median home prices nationwide advanced 14.4 percent in 1979, 13.3 percent in 1980, and 6.8 percent in 1981. As of August 1982, prices were up only 1.8 percent over the same period a year ago (Chart 3).

Over one-quarter of southeastern realtors who responded to our survey indicated that housing prices in 1982 are level with a year ago. Almost a full quarter of them said prices are actually lower this year. Another quarter said prices are only 1-5 percent above last year. The remainder reported a higher growth rate in home prices, suggesting a 1982 median growth rate in home values in the Southeast somewhere between 0-5 percent.

While nominal housing prices are still increasing, the gains are offset by the inflation rate as measured by the consumer price index. In real terms, national housing prices as of August were down 4.1 percent from August 1981.

Several developments suggest that the pace of growth in real estate values will not return to the double-digit levels of the 1970s. First, inflation should continue to subside in the next decade. Second, with deregulation, lending institutions are paying higher rates on deposits and must cover these costs with higher rates on loans. Housing prices will continue to be dampened by the high cost of financing. Buyers who expect much lower interest rates when they refinance balloon notes may find that rates remain unaffordable. Third, government emphasis is changing from stimulating the economy through consumption to stimulating it through savings and investment. The focus is now to "reindustrialize" America rather than to provide quality housing for all Americans. Though politically difficult, this direction has already resulted in reduced government subsidies to residential construction. There is also a movement to reduce the tax incentives to individuals who pay a high interest expense. Most industrial countries have already limited the amount of home mortgage interest which can be claimed as a deductible for income tax purposes. The proposed flat rate tax is one example that would eliminate interest expense as a deductible and could dramatically change the motivation for owning a home.

Fourth, tangible assets such as real estate are the best investments under conditions of inflation, rising taxes, political instability, and government regulation—the conditions which existed for the last decade. On the other hand, paper assets (stocks and bonds) flourish under conditions of more confidence in money, less inflation, declining taxes, a reduced role of government, growth in productivity, and a government that emphasizes investment over consumption—the conditions likely over the next decade. Residential real estate may lose its attraction as an investment. Speculators will likely leave the market. Home owners who currently consider their mortgage payment as part of their savings may find it necessary to channel their savings into more rapidly appreciating investments.

## ● Loan Quality Risks

About 41 percent of the sellers in our survey extended a loan to buyers in order to ease the financing burden on the buyer. These sellers made an average investment of $30,000. Most people, when investing this amount of money in any other financial instrument, would scrutinize the risk and attempt to either minimize it or to receive the maximum return for that risk. However, people who hold second or third mortgages do little to ensure the safety of their investments. The three C's of lending too frequently are ignored.

**Capital**—In making a mortgage, the seller should be concerned with the borrower's capital, or net worth, which includes the value of the asset (the home) securing the mortgage. A lender should never provide financing for more than the asset would be worth in a distress sale.[8] Lending institutions require an accurate appraisal before agreeing on an amount to finance. However, 40 percent of the realtors in our survey said that generally no appraisal is conducted for the individual mortgage holder (Table 1).

**Table 1.** Survey Question
Based on your experience, who performs the following tasks when a seller takes back a mortgage?

| | Response | % of Total Responses |
|---|---|---|
| Appraises property | No one | 40% |
| | Licensed appraiser | 30% |
| | Real estate broker | 24% |
| | Financial institution | 4% |
| | Buyer | 2% |
| Checks credit of buyer | Real estate broker | 33% |
| | Seller | 23% |
| | No one | 16% |
| | Credit bureau | 11% |
| | Financial institution | 10% |
| | Lawyer | 7% |
| Collects Payment | Seller | 70% |
| | Financial institution | 22% |
| | Real estate agent | 6% |
| | Notary | 1% |
| | Lawyer | 15% |

[8]The term "Distress sale" as used here means a sale under conditions which require a quick sale, usually within 60 days.

Whether a formal appraisal is done or not, the buyer, seller, and realtor place a value on the home based on comparable sales in the neighborhood. But creative financing has distorted home values. A home with an attractive financing package generally has a selling price 6-10 percent higher than homes with traditional financing, according to realtors in our survey.[9] Essentially, buyers are paying a premium sales price in order to secure lower financing costs—that is, part of the interest cost is imbedded in the sales price. However, if the buyer is forced to sell the home quickly, he may be unable to provide as attractive a financing package as he originally received. With traditional financing, the home may be worth less than he paid for it. If we consider the true value of the home to be the sales price less the premium paid for a lower interest rate, lenders are at times overextending themselves in granting mortgages which bring total mortgage debt on the home to too great a percentage of the value of the home. In the survey, 15 percent of the homes carried mortgages which totaled more than the discounted value of the home.

**Capacity**—The buyer's cash flow and previous history of loan payment should concern the seller in determining whether the buyer will be able to service all of his debts. In creative financing, credit checks often are casual at best. Sixteen percent of the survey respondents indicated that the buyer's credit record is not checked when arranging creative financing. Less than 25 percent of the respondents said a financial institution or a credit bureau is used to verify credit. The rest of the realtors indicated that the broker, the seller, or a lawyer—someone unskilled as a creditor—performed a credit check (Table 1).

A buyer lacking the capacity to pay eventually will become delinquent. Individual mortgage holders have little power over the borrower who gets behind on payments. During a period of high unemployment, delinquencies may mount. Mortgage loan delinquency rates at financial institutions have climbed in the last several years well above the peak reached in the mid-1970s recession. For the southeastern states, the results are mixed. Alabama, Florida, Mississippi and

[9]This estimate is substantiated by an analysis prepared by G. Stacy Sirmans and Stanley D. Smith of Emory University and C. F. Sirmans of the University of Georgia, "Assumption Financing and Selling Prices of Single-Family Homes." They developed an empirical model which shows that "holding constant other variables which affect selling price, loan assumptions carry higher selling prices than homes purchased with conventional mortgage financing."

**Table 2.** Percent of Total Mortgage Loans Delinquent 30 Days or More Second Quarter Data

| | 1982 | Recent Low | Date | Recent High | Date |
|---|---|---|---|---|---|
| U.S. | 5.18 | 4.21 | 2Q79 | 4.43 | 2Q76 |
| Alabama | 6.00 | 3.63 | 2Q78 | 5.08 | 2Q76 |
| Florida | 4.81 | 3.60 | 2Q79 | 3.86 | 2Q77 |
| Georgia | 5.25 | 5.31 | 2Q79 | 5.93 | 2Q77 |
| Louisana | 3.61 | 3.47 | 2Q78 | 3.91 | 2Q76 |
| Mississippi | 5.44 | 3.76 | 2Q78 | 5.28 | 2Q75 |
| Tennessee | 6.63 | 4.00 | 2Q78 | 4.34 | 2Q76 |

Source: Mortgage Bankers Association National Delinquency Survey

Tennessee are experiencing delinquency rates much higher than during the mid-1970s recession. Louisiana's delinquency experience is slightly better. While Georgia appears better off now than in the mid-1970s, the level of delinqency is one of the highest in the Southeast (Table 2).[10] Since unemployment generally remains high even after a recovery begins, the recession's effect on delinquencies may continue throughout 1983 and possibly into 1984.

Delinquencies are likely to be higher for seller-held mortgages. A pressured debtor will generally pay an institution before he pays an individual because he believes the consequences of default are greater. When sellers do not employ a third party to collect payments, the payment mechanism is usually fraught with late payments and casual procedures. In our survey, 70 percent of responding realtors indicated that sellers make their own collections (Table 1).

The risk is magnified if the seller is using income from the mortgage he is holding to make his own mortgage payments. Defaults and foreclosures are likely to accumulate as individual mortgage holders cannot collect from their own borrowers.

**Character**—The last of the three C's of lending is difficult to assess in any lending situation. Individual mortgage holders generally trust their realtors to recommend buyers of a worthy character. A credit check would give the seller some further indication of character based on the buyers' past record in repaying debt.

[10]Mortgage Bankers Association National Delinquency Survey.

## ● Institutional Risks

Every financial institution with a residential mortgage portfolio has been affected by creative financing. These institutions desperately need to refinance old mortgages to improve the yields on their portfolios. One objective of creative financing is for home buyers to retain those low-interest mortgages. The recent ruling that all financial institutions can exercise due-on-sale clauses will help the institutions, but "creative financers" continue to find ways to avoid activating the due-on-sale provision.[11] Installment land contracts, purchase money options, wraparounds and "silent sales" (see Box for definitions of these terms) are now being used to avoid the requirement. We asked realtors to indicate what techniques they had used specifically to avoid due-on-sale. Renting with the option to purchase was mentioned most often—by 33 percent of the realtors. The next most popular device was wraparounds, with 29 percent. Eighteen percent had used the purchase money option and 12 percent had used the installment land contract. Only 5 percent had tried a silent sale, in which a seller does not notify an institution that a sale has taken place.

Another risk for financial institutions is that borrowers may be stretching their debt burdens by obtaining second and third mortgages exceeding the value of their homes. Often the institution granting the first mortgage is unaware of the added debt of a second or third mortgage. The buyer and seller will make an informal arrangement which looks initially like a cash purchase to the first mortgage lender. The formal second or third mortgage is arranged only after the house is purchased. In the past those second and third mortgages either were unobtainable or too costly for the debt-stretched buyer. However, a borrower can get overextended today when a seller is willing to extend a loan regardless of the borrower's current debts and without notifying the institutional mortgage lender. Additional debt pressures on the borrower increase his likelihood of default particularly if family members become unemployed.

[11]Some states had prohibited enforcement of due-on-sale clauses before passage of the Garn-St. Germain Depository Institution Act of 1982. For mortgages made or assumed in those states during the "window period" (between state prohibition of enforcement and passage of the recent federal Act), enforcement of due-on-sale clauses is still prohibited.

## Rate of Return

Mortgage rates fall into two categories. (1) Market Rates—rates on new mortgages that are set by the dynamics of the marketplace. (2) Below-Market Rates—rates on assumptions of old mortgages, rates on blended mortgages consisting of assumptions and new second mortgages held by an institution or an individual, and rates on mortgages held solely by individuals.

The market rates are set by the institution based on inflation expectation, cost of funds, and risk. A new first mortgage at the time of the survey (second quarter, 1982) carried an interest rate of about 16 percent. Second mortgages from institutions had interest rates averaging 18 percent. Most home sales in our survey involved financing with below-market rates. Only 17 percent of home buyers paid the "market rate of interest." The other 81 percent managed to finance their home at below-market rates using assumptions or creative financing. Sellers applied on average a 12 percent interest rate to the mortgages they took back, regardless of whether the mortgage was a first or a second.

But buyers can be deceived by the face interest rate. In most cases, a home financed at below-market rates will sell for more than homes without low-cost financing. The premium paid should be considered part of the interest cost since it is a cost above the value of the home when financing is disregarded. We asked realtors to detail their most recent sale including their estimate of the premium paid for below-market financing if such a premium existed. Then we used this information to determine the true financing costs to the buyers. Including the cost of any premiums and those mortgages financed at market rates, buyers are still only paying an average 13 percent for their mortgages (Table 3).

While the buyer appears to be getting a break in his mortgage cost, he generally assumes some risk. In the case of balloon mortgages, he will have to refinance, usually in five years. Mortgage rates then may still be prohibitive. He also accepts the risks associated with selling his home. If he cannot provide a comparable financing package for his buyer, his home's resale value may be substantially less than he paid for it.

Sellers are accepting uncompensated risk for the return on their investments. The seller may find that he needs the loaned money sooner than expected, or he may decide to invest in a higher paying instrument. In this case, he can sell the mortgage in the secondary market.

**Table 3.** Survey Question

Realtors were asked to indicate all financing details with regard to their last sale. From this information we were able to calculate the average interest rate paid by buyers during the time of the survey.

| Financing provided by: | % of all sales | Avg. Interest Rate[1] |
|---|---|---|
| Institution only - | 45% | 13.7 % |
| New mortgage | 17% | 15.78% |
| Assumption | 28% | 12.4 % |
| Creative Financing | 53% | 12.4 % |
| All types | 98% | 12.99% |

[1]Interest rate includes sales price premium paid by buyers to obtain low rate financing. Interest rate reflects sales price premium paid by buyers to obtain low rate financing. A premium was assessed only in those cases where the realtor indicated the sales price would have been lower if low rate financing had not been available. The realtor's estimate of the price differential was used as the premium. This amount was subtracted from the mortgage balance. The annual percentage rate was recalculated based on the actual payment amount and maturity but using the discounted mortgage balance. In cases of more than one mortgage, the discount was applied to the first mortgage balance only. To obtain a singular interest rate, the rates on each mortgage were averaged using a weighting technique to take into consideration mortgage balance and maturity.

In selling a mortgage, the value of that mortgage to the buyer must be determined. On a mortgage of $70,000 at 12 percent, an investor might be willing to pay $70,000 to hold that mortgage if comparable investments also yield 12 percent. However, if he could invest the $70,000 at a higher interest rate with comparable maturity and risk, he would be better off. When secondary mortgages are trading at 15 percent, a 12 percent loan can be sold only at a substantial discount.

According to the survey, sellers often find it necessary to take their losses. One-third of the realtors knew of sellers who had sold their mortgages at a substantial discount.

Additionally, the seller accepts the risk of default. If the buyer does not make payment for 90 days, the seller can foreclose, but is generally reluctant. He may not want the responsibility of selling the house again. Foreclosure is still perceived as "villainous" by society and is usually avoided as long as possible. The delay and the process of foreclosure create a cash flow problem for the lender who is depending on the income

## COMMONLY USED CREATIVE FINANCING TECHNIQUES—SURVEY RESULTS

Creative financing in our survey is defined as any financial arrangement for a real estate transaction involving a non-institutional supplier of funds. The most common techniques involve the seller holding a mortgage at a below-market interest rate. Other methods include the builder or developer supplying funds, the buyer's employer supplying funds, the realtor holding a mortgage, or the seller renting or leasing the property with a purchase option. Our survey indicates that creative financing was used to fund 53 percent of southeastern realtors' home sales in the first half of 1982 (Table 4).

**Seller-held mortages**, which come in a variety of forms, occurred in 41 percent of residential real estate transactions in the Southeast survey. Often (26 percent of the time) the buyer assumed the existing first mortgage or obtained a new first and the seller held a second. In 9 percent of all transactions the seller held the first and only mortgage. Balloon financing, in which the mortgage's maturity is shorter than its amortization period, was used in 19 percent of all transactions In these cases, the buyer is obligated to pay the remaining debt to the seller at maturity—usually in five years.

Another form of financing which may involve the seller is the **wraparound** mortgage. The seller continues to make payments on the existing mortgage but writes a new mortgage to the buyer at a lower-than-market interest rate. The lender uses part of the buyer's payment to make the first mortgage payment and keeps the remainder for himself. Wraparounds were used in 6 percent of all transactions in the survey.

Creative financing is most commonly used for the sale of existing homes. However, builders and developers have begun to offer attractive financing packages in an effort to sell newly constructed homes. While builders are not generally in the position to hold mortgages, they may offer to **buy down** interest rates for several years to make a new home more affordable. The buyer finances through a lending institution, but his interest cost is reduced for the first few years by a lump sum payment the builder makes at closing. At the end of that initial period, the interest rate changes to some pre-indexed rate. This technique is also used by corporations to assist employees required to change job locations. Buy-downs were used in 8 percent of real estate transactions in the survey.

A special type of buy-down is the **zero interest mortgage.** A home is financed for five years through a financial institution, and the builder pays all of the interest. The buyer owns the house at the end of five years. Only two sales, or less than 1 percent of the transactions in the survey, employed this type of mortgage.

Not surprisingly, **realtors** have also begun to help out in providing financing. In nine transactions, or 3 percent of the time, the realtor provided some or all of the financing to close a sale.

Other alternatives include various forms of renting. In these contracts the buyer lives in the home and makes payment to the seller, who retains the title. One form is a straight **rental** in which the buyer makes a monthly payment. He may be given the option to purchase by a specific date, when he has accumulated a large enough downpayment, or when he can obtain institutional financing. Renting with the option to buy was used in 3 percent of the transactions in the survey.

Another form of creative financing which involves renting is the **"purchase money option."** In this arrangement, the buyer lends the seller an amount up to the seller's equity as a second mortgage on the property. In return, the seller gives the buyer an irrevocable option to buy for a period of between three and five years. The buyer pays rent to the seller until he can obtain adequate financing and exercise his option to buy. The purchase money option was offered in only two cases, or less than 1 percent of the survey transactions.

A third alternative that looks like a rental is the **installment land contract.** The buyer makes installment payments to the seller who retains title to the property. At the end of the installment period, the buyer must obtain the financing to buy the property. During this time, the buyer accumulates no equity in the home, but he is able to deduct the payments from his tax liability as interest expense. Only three, or about 1 percent, of the survey transactions used this approach.

**Barter** is another possible means of a buyer providing something of value to a seller. This approach was mentioned in one transaction in the survey.

**Table 4.** Southeastern Residential Real Estate Survey
Financing by Source January-June, 1982

| | Number of Sales | % of Total Sales |
|---|---|---|
| Cash | 8 | 2% |
| Financial Institution only | 150 | 45% |
| Creative Financing[1] | | |
| Seller-Financing | | |
| 2nd Mtg without balloon | 41 | 12% |
| 2nd mtg with balloon | 47 | 14% |
| 1st Mtg without balloon | 13 | 4% |
| 1st Mtg with balloon | 17 | 5% |
| Wraparound | 19 | 6% |
| Buy-downs | | |
| Partial | 22 | 7% |
| Zero-interest Mtg | 2 | 1% |
| Realtor | 9 | 3% |
| Barter | 1 | 0% |
| Rental Alternatives | | |
| Rent/Lease w/option to buy | 11 | 3% |
| Purchase money option | 2 | 1% |
| Installment land contract | 3 | 1% |
| | 175 | 53% |
| | 333 | 100% |

[1]Creative financing is defined as any financial arrangement facilitating a real estate transaction which involves a noninstitutional supplier of funds. For example, a straight assumption of a low rate mortgage at a savings and loan would not be considered creative financing. An assumption plus a second mortgage held by the seller would be considered creative financing.

from the mortgage. Even after foreclosure proceedings begin, the process may take another nine months to finalize. The seller must be financially able to forego his income and make the first mortgage payments during foreclosure proceedings and until he can resell the property.

At lending institutions across the nation three-fourths of the mortgages delinquent 90 days or more were in foreclosure in mid-1982. In the Southeast, however, foreclosure is less common. Only 40 percent of defaults are being foreclosed in Alabama, 48 percent in Florida, 58 percent in Georgia, 56 percent in Louisiana, 42 percent in Mississippi and 52 percent in Tennessee.[12]

## Alternatives

Many of the loans arranged outside traditional credit markets have a thin margin of error. The risks that buyers and sellers take in creative financing increase the likelihood of real estate losses in the next few years.

Compare seller-financing of a home with seller-financing of an automobile. We do not generally think of housing and automobiles in the same way with regard to financing. Houses have tended to **appreciate** in value; automobiles **depreciate** in value. Yet there are attendant costs to owning a home similar to the depreciation costs of automobiles. Houses are subject to some technological obsolescence requiring the replacement of heating and air-conditioning systems, for example. Likewise, new model cars are more efficient and technologically advanced than older models. Weather conditions wear on a home, requiring frequent painting or possibly roof replacement. Automobile bodies reflect age and exposure to the elements. Homes require insurance against natural disasters just as casualty insurance is required in owning an automobile. Daily living and traffic through a home wears out carpets, draperies and appliances which must be replaced. Likewise, automobile engines and interiors eventually degenerate.

If an individual were asked to finance the sale of his used Cadillac at 12 percent for $15,000, he would probably decline giving reasons such as: "The car may not hold its value over the life of the loan. I have no means to insure the buyer will make timely payments. I need the cash to buy a new car. I could invest the cash at the same interest rate somewhere else with less risk of loss. If the buyer does not maintain the car, my collateral loses value." Creative financers should examine their transactions in this same light.

There **are** other alternatives for financing homes that buyers and sellers should recognize. The first is to negotiate based on effective sales price rather than financing terms. The second is to work closely with a financial institution to obtain a financing package comparable to what sellers are offering.

In our survey, there were several cases where simply lowering the price of the house would have affected neither the buyer's cost nor the seller's return. In these cases, the buyer could finance a smaller sum through a financial institution at a higher interest rate while making the same monthly payment. He would be better off, in fact, since he would pay a relatively higher proportion in interest, which is tax deductible. Although the seller would receive a lower price, he would be able to invest the cash he received at a higher interest rate with less risk and greater liquidity.

The tax effect often is not considered by buyers who pay a sales price premium to secure lower financing costs. To obtain favorable financing, the buyer might offer to pay the seller discount points instead of a sales price premium. As long as the number of points is reasonable and comparable to points charged by financial institutions, the buyer's points expense will be tax deductible. If instead these discount points are labeled part of the sales price, as is generally the case, the buyer foregoes his immediate tax benefit. Sellers may object because discount points are taxed as interest income, whereas the sales price received would be taxed as capital gains. Nevertheless, both buyers and sellers should be aware of the tax consequences when negotiating a financial arrangement.

In financing a newly constructed home, the buyer might consider carrying the builder's construction loan and allowing the builder periodic advances on a percentage completion basis. The home buyer saves the builder the cost of financing by getting advances directly from the financial institution. For the buyer, advantages are threefold: 1) he is able to deduct from his adjusted gross income the interest expense normally added to the builder's construction cost thus reducing his tax obligation; 2) the buyer is able to assume the builder's construction loan, assuming

[12]Calculated from data reported in Mortgage Bankers Association National delinquency Survey.

his credit status permits; 3) and finally, the buyer is able to wait for a lower interest rate rather than have to renegotiate a new mortgage at a future time. At the same time, this arrangement permits the builder the opportunity of actually lowering the fixed price of the contracted home, since he incurs no borrowing costs, and it passes the tax advantage directly to the party who can benefit most.

Home buyers and sellers also are now offered many more options through local financial institutions. Often buyers can obtain the same rates that sellers are willing to accept by using alternative mortgage instruments. For sellers, risk is eliminated when they can avoid holding a mortgage.

## Summary

Creative financing is a response to the past few difficult years in the real estate market. Sellers accept the risks involved because they believe that taking back a low-rate mortgage will sustain the value of their home and that its value will continue to appreciate. Buyers cannot afford the cost of financing new mortgages. Realtors have become increasingly innovative in an effort to continue making sales.

Financial arrangements today are often made with insufficient regard to risk. Loans are made to accomplish the objective of selling a home with little concern for the soundness of the investment. Changes in the housing market in general may dampen the investment value of homes. The assumption that housing will continue to appreciate at double-digit rates may prove incorrect, leaving lenders with over-valued investments. Selling prices are inflated by the attractiveness of the financing package. Often the total amount of the mortgage is greater than the value of the home under distress conditions. Loan quality is questionable in creative financing since the lender does little credit analysis. Collections may become a problem for seller-financers as delinquencies swell. Sellers suffer substantial losses if they choose to sell a low-rate mortgage on the secondary market or if they are forced to foreclose.

As publicity mounts about disappointing creative financing deals and as consumers are offered more financing alternatives, buyers and sellers will learn to make wiser decisions. Sellers do not have to hold mortgages to attract buyers. Accepting a lower sales price may be worth the freedom from holding a mortgage. Financial institutions increasingly are offering mortgage instruments that accommodate buyers' needs. When the seller does decide to hold a mortgage, he can make more formal arrangements for analyzing the buyer's credit-worthiness, appraising the property, and servicing the loan. Paying a small fee to obtain professional, expert services and advice may avoid losses later.

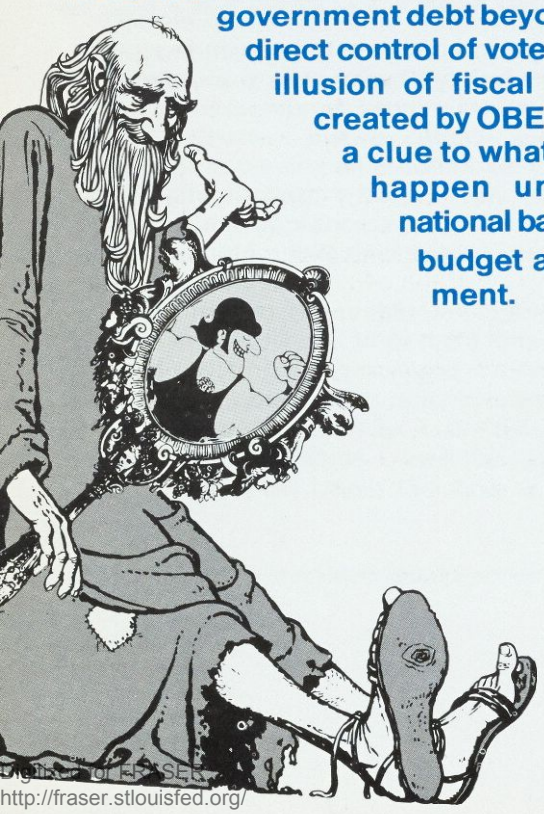
**—Donald L. Koch,**
**Delores W. Steinhauser**
**and Keith R. Ihlanfeldt**

*The authors wish to thank Frank King and Robert Baker for their helpful comments and contributions. Ihlanfeldt is on the economics faculty at Georgia State University.*

# The Limitations of Spending Limitation

## State and Local Governments: Off-Budget Financing and the Illusion of Fiscal Fitness

**Proliferating "off-budget enterprises" have put more than half of all state government debt beyond the direct control of voters. The illusion of fiscal health created by OBEs gives a clue to what might happen under a national balanced budget amendment.**



Large and persistent federal deficits have been a prime factor in the Reagan administration's recent endorsement of a constitutional amendment mandating a balanced budget. This initiative is by no means new; over the past decade 31 states have adopted resolutions calling for a constitutional convention to adopt such an amendment. There is, apparently, widespread concern that only constitutional change can bring expenditures and revenues into balance.

Many express confidence that a balanced budget amendment can induce government to be more efficient and to reduce excessive spending. However, the historical evidence on such restrictions indicates that this faith is not based on fact. For nearly a century, state and local officeholders have avoided similar fiscal constraints by simply redefining their budgets. The evidence shows that state and local governments have bypassed expenditure and debt controls by resorting to "off-budget enterprises" (OBEs).

At the federal level, off-budget operations have grown more rapidly in recent years than on-budget spending. As pressures for a balanced budget mount, off-budget operations can be expected to play a major role in circumventing the taxpayers' desire for a fiscally balanced federal sector.[1] In a sense, government has "gone underground" and, rather than reducing its size and scope, has merely concealed much of its borrowing and spending.

### Off-Budget Enterprises

State and local governments have routinely side-stepped fiscal limits by creating off-budget enterprises beyond the direct control of taxpayers.

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[1]The "underground federal government" is the focus of an article in a forthcoming issue of this **Review**.

OBEs are corporations created and owned by one or more political jurisdictions and are usually referred to as authorities, districts, commissions, agencies, and boards. They are formed by a public statute that defines their powers. In more than two-thirds of the states, a local government may establish an OBE by ordinance. In most states, all that is required is the filing of a corporate charter. In a few states, such as New York, OBEs must be chartered by special acts of the legislature.

Thousands of OBEs exist at the local level, including more than 2,500 in Pennsylvania alone.[2] OBEs have no taxing power, by definition. Rather, their activities—which include the entire spectrum of local governmental activity from airports to zoo maintenance—are financed by issuing non-guaranteed revenue bonds. Such issues need not be approved by any elected body. Since revenue bonds are not subject to voter approval, they are not backed by the taxing powers of any governmental unit. Theoretically, they are backed by user fees from the OBE's activity.

OBEs enjoy a favorable status in many respects. Because OBEs typically do not receive appropriations, their spending and debt do not appear on government budgets. Although OBEs are theoretically "financially independent," in reality they are subsidized by other units of government. OBE managers often enjoy far greater discretion than do managers of regular local governmental departments. Some OBEs are exempt from many state and federal regulations, enjoy powers of eminent domain that can extend beyond the boundaries of the political entity which created the OBE, and are often exempt from antitrust laws regarding price fixing.[3] Moreover, the expenditures, borrowing, and employment of OBEs are often not included in the reported statistics of the political jurisdictions that form them.

## The Case of Pennsylvania

The major difference between regular governmental departments and OBEs is that OBEs can raise and spend money without approval of the electorate or its elected representatives. The evolution of OBEs in Pennsylvania illustrates how the establishment of OBEs can circumvent the electorate's wishes whenever the voters demand fiscal restraint by local political decision-makers.[4]

During the late 19th and early 20th centuries, heavy borrowing by local governments in Pennsylvania led to frequent financial crises and defaults on debt payments. As lenders and taxpayers became more suspicious of public borrowing, the state legislature imposed severe restrictions on municipal borrowing by limiting it to seven percent of assessed property valuation, in the hope that such action could constrain irresponsible borrowing practices by local officials.

In 1935, however, the Pennsylvania legislature passed the Municipal Authorities Act, which exempted "government-owned corporations" from municipal debt restrictions. OBEs soon were created to finance school buildings, airports, parking lots, recreation centers, and various other activities. Local governments had found a way of insulating themselves from the immediate wishes of the voters and the intent of the state constitution's restrictions on local borrowing.

Next, in the late 1940s, Pennsylvania voters began pressuring their state representatives to limit local property taxes. As a result, in 1949 statutory property tax rate limits were placed on cities, boroughs, townships, and school districts. Again, the response of local political bodies was to turn to off-budget mechanisms. The number of "municipal corporations" created in Pennsylvania tripled in 1950, and the amount of non-guaranteed bonds issued increased almost five-fold in that year, from $11.5 million to $64 million. Thirty-four "school building authorities" alone were formed in 1950 compared to just 14 in the preceding 15 years. The amount of non-guaranteed debt issued by school building authorities increased by 583 percent in 1950, from $2 million to $11.8 million.

By 1975 the number of OBEs in Pennsylvania had risen to 2,456 with $4.8 billion in debt outstanding. This compared to $2 billion in voter-approved "full faith and credit" local debt outstanding. As of that year, 71 percent of all Pennsylvania local debt was not approved by taxpayers and therefore beyond their control.

As elsewhere, there are two types of OBEs in Pennsylvania: "lease-back" and "general operating" authorities. Lease-back authorities do not operate public facilities; they issue revenue

[2]Donald Schlosser, **Municipal Authorities in Pennsylvania** (Harrisburg, PA: Department of Community Affairs, 1977).
[3]Annmarie Walsh, **The Public's Business: The Politics and Practices of Government Corporations** (Cambridge: MIT Press, 1979).

[4]The following is based on Donald Schlosser, **Municipal Authorities in Pennsylvania.**

**Table 1** . Nonguaranteed Local Government Debt in Indiana, Kansas, Minnesota, Montana, Wisconsin: 1962, 1972, 1978
(Millions of Dollars)

| | 1962 | | 1972 | | | 1978 | | |
|---|---|---|---|---|---|---|---|---|
| State | Amount | % of Total | Amount | % Change 1962-72 | % of Total | Amount | % Change 1972-78 | % of Total |
| Indiana | $459.1 | 52.8 | $966.4 | 110 | 53 | $1,957.6 | 103 | 68 |
| Kansas | 160.0 | 25.6 | 444.8 | 178 | 44 | 1,161.5 | 161 | 56 |
| Minnesota | 175.3 | 16.5 | 391.8 | 124 | 14 | 1,421.9 | 263 | 33 |
| Montana | 35.7 | 27.5 | 63.4 | 78 | 37 | 376.4 | 494 | 70 |
| Wisconsin | 128.9 | 12.8 | 217.1 | 68 | 11 | 705.0 | 225 | 24 |

Source: **Compendium of Governmental Finances** (Washington, D.C.: Bureau of the Census, 1962, 1972) and **Moody's Municipal and Government Manual** (New York: Dun and Bradstreet Co. 1981).

bonds and invest the proceeds in various projects, which they then lease to local governments for specified rental payments paid out of local tax revenues.

Most OBEs are of this type. Their organizational structure provides local political decisionmakers with even greater insulation from the wishes of the electorate. For example, the Pennsylvania legislature has not yet granted municipalities the right to create lease-back electric utility authorities. Not to be constrained by either voters or their elected state representatives, some local officeholders have evaded this restriction by creating lease-back water authorities, selling their existing water systems to them, and using the sale proceeds to expand municipally owned electric power systems. Furthermore, many municipalities sell existing facilities to specially created OBEs and then lease them back simply to place them off-budget.

Pennsylvania is not a special case. In 1980, of the nation's approximately $48.4 billion in long-term municipal security sales, fully $34.3 billion or 71 percent were nonguaranteed revenue bonds. That percentage had grown from 48 percent in 1975 and 34 percent in 1970.[5] As of 1975, the nonguaranteed debt of public authorities and special districts represented the largest single source of new state and local government security sales, reaching $23.4 billion by 1979. In contrast, guaranteed (and voter-approved) debt in that year totaled $4.4 billion for state governments and $15.6 billion for municipalities, counties, and townships combined.[6] Special districts and public authorities were responsible for 54 percent of state and local government security sales in 1979, compared to 31 percent nine years earlier.

## The Off-Budget Response to the Tax Revolt

Off-budget enterprises at the local government level were used to cope with the "taxpayer revolt" of the 1970s, when numerous statutory and constitutional restrictions were imposed on the power of local governments to tax and spend. Local officeholders across the country have responded in much the same way as those in Pennsylvania. Five states enacted tax or spending limitations on local governments during the early 1970s: Indiana (1972), Kansas (1970), Minnesota (1972), Montana (1974), and Wisconsin (1973). Table 1 shows the nonguaranteed local government debt in these states in 1962, 1972, and 1978. In each of these states, both the amount of nonguaranteed debt and the proportion of non-

[5]Public Securities Association, **Statistical Yearbook of Municipal Finance** (New York: Public Securities Association, 1981), p. 124.

[6]U.S. Bureau of the Census, **Statistical Abstract of the U.S.** (Washington, D.C.: U.S. Government Printing Office, 1980), p. 300.

**Table 2.** Nonguaranteed Local Government Debt in States Without Tax or Expenditure Limitations Prior to 1977
(Millions of Dollars)

| State | 1962 Amount | 1962 % of Total | 1972 Amount | 1972 % Change 1962-72 | 1972 % of Total | 1978 Amount | 1978 % Change 1972-78 | 1978 % of Total |
|---|---|---|---|---|---|---|---|---|
| Arkansas | $ 88.6 | 34 | $ 517.0 | 574 | 64 | $ 650.6 | 26 | 60 |
| California | 1,477.8 | 26 | 3,858.1 | 161 | 34 | 6,152.3 | 59 | 43 |
| Connecticut | 145.9 | 18 | 149.2 | 2 | 12 | 309.0 | 107 | 20 |
| Hawaii | 37.9 | 28 | 47.5 | 25 | 18 | 33.4 | −30 | 10 |
| Maine | 41.1 | 35 | 31.5 | −23 | 14 | 29.2 | −7 | 21 |
| Massachusetts | 373.3 | 30 | 296.9 | −20 | 11 | 883.0 | 197 | 24 |
| Tennessee | 481.8 | 41 | 912.5 | 89 | 40 | 1,517.0 | 66 | 42 |
| Vermont | 3.2 | 7 | 8.6 | 169 | 7 | 22.6 | 163 | 19 |
| Maryland | 221.3 | 18 | 371.6 | 68 | 15 | 588.4 | 58 | 17 |
| New Hampshire | 12.7 | 14 | 29.2 | 130 | 12 | 41.3 | 41 | 11 |

Source: **Compendium of Governmental Finances, Moody's Municipal and Government Manual.**

guaranteed local debt increased more during the post-limit 1972-78 period than during 1962-72.

The sharpest increase came in Montana, where nonguaranteed debt increased five-fold between 1972 and 1978, and where the proportion of nonguaranteed debt almost doubled from 37 percent to 70 percent. In both Wisconsin and Minnesota, where the proportion of nonguaranteed debt had declined between 1962 and 1972, it more than doubled during the post-limit 1972-78 period. Indiana's nonguaranteed to total debt ratio remained approximately constant for the 10 years prior to limitation. Then it rose from 53 percent in 1972 to 68 percent six years later. The amount of nonguaranteed local government debt in all five states increased by 249 percent during the six years after 1972. (It had only risen 112 percent during the previous decade).

States that enacted no restraints on local government taxing and spending powers prior to 1977 experienced a slower increase in the amount of nonguaranteed debt issued, and had a lower proportion of nonguaranteed debt ratios, as Table 2 shows. These "non-limitation" states had an average proportion of nonguaranteed debt of 26.7 percent in 1978, compared to 50.2 percent in the "tax-limitation" states. Between 1972 and 1976, the proportion of nonguaranteed debt increased, on average, by 5.6 percentage points in "nonlimitation" states, compared with 18 percentage points in "tax-limitation" states.

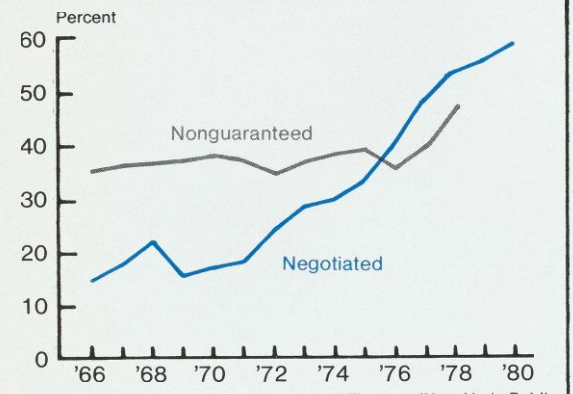
So even though tax and expenditure limits may have reduced the growth of on-budget local expenditures in these five states, billions of dollars of debt and expenditures were placed off-budget through the OBE device.

Many consider the June 1978 passage of California's Proposition 13 as the beginning of the "taxpayer revolt." Actually, the revolt was simmering throughout the 1970s. Eleven states passed 18 different limitation initiatives during the 1970-73 period.[7] Three more spending restrictions were passed in 1974 and 1975. In 1975, voters approved only 29 percent of the dollar amount of bond issues subject to referendums. In 1976 and 1977, 11 states imposed tax or spending limits on local governments, followed by 16 more states in the following two years, including California's Proposition 13. Thus it appears that the "tax revolt" had been building through the 70s.

Not surprisingly, the 1970s also brought a large amount of off-budget spending and borrowing activity at the local level of government. Chart 1 plots the percentage of nonguaranteed and negotiated municipal security sales.[8] Nearly all guaranteed municipal securities are sold through competitive bids among a number of competing

[7] Advisory Commission on Intergovernmental Relations, **State Limitations on Local Taxes and Expenditure** (Washington, D.C.: ACIR, 1981).
[8] Data on municipal security sales were obtained from Public Securities Association, **Statistical Yearbook on Municipal Finance.**

**Chart 1.** Nonguaranteed and Negotiated Municipal Security Sales




Source: **Statistical Yearbook of Municipal Finance** (New York: Public Securities Association, 1981) p. 124.

underwriters. OBE issues, on the other hand, generally are negotiated with a single underwriter. Throughout the 1970s there has been a continuous increase in both the nonguaranteed and the negotiated ratios. A striking feature of Chart 1 is the sharp increase in the nonguaranteed percentage after 1976, with the intensification of the tax revolt. After an average yearly increase of about 19 percent for 10 years, the amount of nonguaranteed local debt issued in 1977 increased by 66 percent, from $17.2 billion to $28.6 billion. At the same time, sales of guaranteed debt fell from $18.2 billion in 1976 to $14.1 billion in 1977, increasing the percentage of nonguaranteed debt from 49 percent of the total debt to 67 percent.

The percentage of negotiated sales also rose sharply with the intensification of the "tax revolt." After increasing by an average 27 percent a year from 1966-1974, the volume of negotiated municipal security sales increased by 52 percent, from $6.9 billion to $10.6 billion in 1975. That is largely the result of the small percentage of guaranteed debt (29 percent) approved by voters during the year. Between 1975 and 1980, the volume of negotiated municipal security sales increased by 162 percent, from $10.6 billion to $27.8 billion, while competitively bid sales remained at approximately $19.5 billion. The percentage of negotiated sales rose from 35 percent in 1974 to 59 percent in 1980. Thus the tax revolt has incited a rapid increase in the growth of the off-budget local public sector, although this expansion may have leveled off since 1979.

As a final piece of evidence, consider the pattern of new issues of state and local government securities, by purpose, as shown in Table 3. The category "Special District/ Statutory Authority," which is the Census Bureau's terminology for off-budget enterprise, lists the nonguaranteed debt of OBEs at local and state levels. These data show a striking increase in OBE debt beginning in 1975. Since 1975, OBE debt has been the largest and fastest-growing type of state and local government debt issued. OBE debt increased by 172 percent between 1974 and 1980, while the voter-approved debt of municipalities, counties, and townships combined increased by 44 percent, and the guaranteed debt issued by state governments actually declined by 9 percent.

Overall, new issues of nonguaranteed debt continued to increase through 1979, although not as rapidly as during 1974-77, while guaranteed debt issues fell steadily from 1976 to 1979. The sharp decline in guaranteed debt from 1978 to 1979 is mainly responsible for the fact that total state and local debt issued fell in 1979 for the first time in 10 years. This evidence, while incomplete (since some states do not gather local data on OBE activity) suggests a strong increase in off-budget spending and borrowing in 1977, an increase that is continuing, but at a slower rate.

In summary, available data show that local and state officials responded to the tax and spending limitations of the "tax revolt" of the 1970s by placing billions of dollars of debt and expenditure off-budget. It is therefore difficult to say whether the "tax revolt" actually reduced the tax burden at the local level. Even if data on property taxes show a slowdown, OBEs need to be included. The true opportunity cost of government is not measured by explicit taxes, but by government spending, and there is no conclusive evidence that local government spending has been reduced.[9]

## Underground State Government: The Case of New York

Off-budget enterprises also are prevalent at the state level of government. There are hundreds of OBEs at the state level nationwide, more of them in New York than elsewhere. Voters in New York State cannot control spending by the

[9]Milton Friedman, "The Limitations of Tax Limitation," **Policy Review** (Summer 1978), pp. 1-13.

**Table 3.** New Issue of State and Local Government Securities: 1970-1979
(Billions of Dollars)

| Item | 1970 | 1972 | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 |
|---|---|---|---|---|---|---|---|---|---|
| All Issues | 18.2 | 23.7 | 24.0 | 24.3 | 30.6 | 35.3 | 46.8 | 48.6 | 43.5 |
| Guaranteed | 11.9 | 13.3 | 12.3 | 13.6 | 16.0 | 18.0 | 18.0 | 17.9 | 12.1 |
| Nonguaranteed | 6.1 | 9.3 | 10.6 | 10.2 | 14.5 | 17.1 | 28.7 | 30.7 | 31.3 |
| Type of Issues | | | | | | | | | |
| State | 4.2 | 5.0 | 4.2 | 4.8 | 7.4 | 7.1 | 6.4 | 6.6 | 4.4 |
| Special District/Statutory Authority | 5.6 | 9.5 | 9.5 | 8.6 | 12.4 | 15.3 | 21.7 | 24.2 | 23.4 |
| Municipalities, Counties, Townships | 8.4 | 9.2 | 10.2 | 10.8 | 10.7 | 12.8 | 18.6 | 17.7 | 15.6 |

Source: **Statistical Abstract of the U.S.** (Washington, D.C.: U.S. Bureau of the Census, 1980), p. 300.

state's OBEs, either constitutionally or by referendum.

As governor of New York, Nelson Rockefeller encouraged off-budget finance during his terms of office between 1959 and 1974. The state constitution strictly limits the issuance of debt; since 1846, a referendum requirement has mandated voter approval of state borrowing. During Rockefeller's administration, taxes were raised (at an annual rate of 12.6 percent during the governor's first term), but the revenues were not sufficient to support state spending plans.[10]

Voters frequently turned down bond referendums, but the restrictions were circumvented repeatedly through creation of off-budget enterprises. For example:

After voters rejected a $100 million housing bond issue for the third time in 1956; Governor Rockefeller created the Housing Finance Authority. This authority issued large amounts of nonguaranteed debt, at one point amounting to more than the entire guaranteed debt of New York State.

After voters rejected a $500 million higher-education bond issue for the fourth time in 1961; the governor created the off-budget State University Construction Fund.

After voters rejected, in 1965, a housing bond issue for the fifth time, the governor created the Urban Development Corporation.

By 1962, Rockefeller's fourth year as governor, there were 125 OBEs in New York State. Twenty-six of them were statewide entitites, with a total outstanding debt of $3.3 billion. By the time Rockefeller left office in 1973, OBE debt had quadrupled.[11] At $13.3 billion, the debt was approximately four times the amount of guaranteed, voter-approved borrowing. The debt of the Housing Finance Authority alone exceeded the entire guaranteed debt of the state by about 50 percent.

In the areas of health and higher education, voter-approved debt stood at $283 million compared to approximately $5.8 billion in nonguaranteed debt outstanding for these functions. From 1964 to 1974 the state's direct debt for construction programs increased by $2 billion, while the nonguaranteed debt of OBEs increased by $8 billion. So there is little evidence that referendum requirements place much constraint on government borrowing in New York State.

In some ways, New York State has served as a prototype for other states. State housing agencies modeled after New York's Housing Finance Authority have proliferated in the past 20 years. An association of HFAs has set up Washington offices. The Council of State Governments, comprised of state-level politicians and bureaucrats across the country, has actively encouraged the use of OBEs in 1970 as a means of being more

[10]Peter McClelland and Alan Magdovitz, **Crisis in the Making: The Political Economy of New York State Since 1945** (Cambridge: Cambridge University Press, 1981).

[11]New York State Moreland Act Commission, **Restoring Credit and Confidence: A Reform Program for New York State and Its Public Authorities** (Albany: State Printing Office, 1976). Much of the material here citing the experience of the 1960s and early 1970s comes from this source.

"flexible" in light of voter-imposed spending constraints :

> Constitutional debt limits are still the rule not the exception. Technology continues to expand the area for delivery of government services. Complex interrelationships between government agencies at different levels require administrative flexibility; the authority device may be less rigid than the usual government agency.[12]

The overall magnitude of the activities of statewide OBEs in the United States is difficult to gauge, since many states do not even maintain data or information on OBE activities.

However, some light can be shed on the volume of OBE activity by monitoring the volume of nonguaranteed state debt issued in the securities markets. In 1977 of total state government debt outstanding of $87.2 billion, $44.3 billion or approximately 51 percent represented the nonguaranteed debt of OBEs.[13] Nine states (Arizona, Arkansas, Colorado, Indiana, Iowa, Kansas, Nebraska, South Dakota, and Wyoming) issued only nonguaranteed debt in 1977, in the amount of $1.8 billion.

The nonguaranteed proportion of total debt has increased steadily from 18.5 percent in 1950 to 55.9 percent in 1978.

Statewide OBEs are quite active in each of the 50 states. They conduct all of the public borrowing in nine states, and on an aggregate level are responsible for more than half of all state government debt outstanding. These data have ominous implications for the American taxpayer: Off-budget mechanisms are now in place and operating on a wide scale that can thwart, to a large extent, any attempts at constitutional constraints on state-level taxing, borrowing, and spending.

We can make a rough approximation of the spending, as well as the debt, of all statewide OBEs even though spending data are not available. "On-budget," the average state spent approximately one-fourth of New York State's spending in 1979.[14] If we assume that **off-budget** spending also averages about one-fourth of New York's (given that OBE spending in New York State was near $8 billion in 1980), off-budget spending by state-level OBEs nationally would be about $106 billion for that year. If we instead assumed OBE spending was one-eighth of New York's, such spending nationally would be about $57 billion. These estimates compare with $143 billion of on-budget spending.[15] So the two types, on and off, are of the same magnitude.

## Concluding Comments

American taxpayers for decades have attempted to restrain the size of government by limiting taxes, spending, and borrowing and to make the public sector more cost conscious and responsive, particularly at the state and local levels. Voters and officials have enacted both constitutional and statutory constraints on taxing, spending, and borrowing at the state and local level. The evidence cited here shows, however, that such limitations have been accompanied by the expansion of off-budget enterprises not subject to voter approval.[16]

Off-budget enterprises undertake a massive amount of investment activity which is beyond the direct control of the voters, approximates that of regular units of government, and has been increasing rapidly as a result of state-imposed local government tax and expenditure limitations. Because the spending, debt, and employment of off-budget enterprises are not included in the budgets or statistics of the political entities that form them, the reported size of the state and local public sector is increasingly understated.

These findings imply clearly that if a balanced budget amendment were added to the federal constitution, the intent of that amendment would likely be sidestepped through the creation of federal authorities for off-budget expenditures. Only increased pressure by voters is likely to achieve a realistic opportunity to limit OBEs and thus restrain government spending.

**—James T. Bennett and Thomas J. DiLorenzo**

*DiLorenzo is on the economics faculty at George Mason University.*

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[12] Council of State Governments, **State Public Authorities** (Washington, D.C.: C&G, 1970), p. 26.

[13] Advisory Commission on Intergovernmental Relations, **Significant Features of Fiscal Federalism: 1980-81** (Washington, D.C.: ACIR, 1981), p. 12.

[14] Tax Foundation, Inc., **Facts and Figures on Government Finance** (Washington, D.C.: Tax Foundation, 1979), p. 167.

[15] U.S. Bureau of the Census, **Census of Governments** (Washington, D.C.: Department of Commerce, 1977).

[16] OBEs are not unique to the U.S., but also exist in Great Britain, Japan, Israel, Australia, France, and Italy, to name a few countries which also have thriving underground governments.

# Southern Fireworks: Will Defense Spending Light Up the South?

**Parts of Florida are likely to boom from increased defense spending, but the impact on other southeastern states may be less pronounced.**

President Reagan aims to reload America's armed forces to an extent unmatched since World War II. United States rearmament in the coming years, following a decade of slowing defense spending, is likely to have an increasing impact on the national economy (see Box 1). Defense spending may have an even greater impact on the economies of some southeastern states.

Florida stands to be among the nation's big state winners from defense spending in the years ahead. Increased defense spending will also stimulate the economies of other states in the Southeast, but the benefits will vary by state and specific localities. Whether the region will benefit disproportionately compared to other regions is a much more difficult question. The region as a whole boasts a relatively high concentration of Department of Defense (DOD) personnel, but a smaller-than-proportionate share of employment in industries producing for defense. Because increases in defense outlays are earmarked mainly for the purchase of defense goods, several Southeast states appear likely to receive an actually smaller share of the expanded budget than in previous years.

## Regional Impact of Defense Spending

The defense expansion planned for coming years will have a dramatic impact on local and,

## BOX 1

## NATIONAL DEFENSE SPENDING IN PERSPECTIVE

Nationally, proposed defense spending hikes raise important economic issues. Can we produce the massive build-up of missiles, ships, tanks, and airplanes without a lot of waste? What will be the impact of defense spending on economic growth, inflation, interest rates, taxes, and government deficits?

### What the Build-up Will Entail

The Reagan administration's defense plan accelerates former President Carter's reversal of a decade-long trend toward less real defense spending. Defense outlays fell from $101.7 billion (1972 dollars) in fiscal 1968, the peak year of spending on the Vietnam conflict, to $67.5 billion in fiscal 1978. Real defense spending then increased under Jimmy Carter, rising to $77.8 billion in fiscal 1981. As a percentage of GNP over the 1968-78 period, defense spending declined from a post-1950s peak of 9.4 percent in 1968 to 5 percent in 1978. By 1981, the share had risen only to 5.7 percent, still below the 6.5 percent average for the 1970s and far less than the averages for the 1950s and 1960s. Critics claim the 1970s slowdown in defense spending, combined with continuing growth of Soviet military power, caused our spending to fall behind the USSR and make our weapons obsolete. The President's aim is to re-arm now to maintain the adequacy of our security.

The cost of a stronger defense posture is a 9 percent increase in real military spending between 1981 and 1987, according to the 1982 **Economic Report of the President**. This spending, including military retirement, is slated to account for 7.8 percent of GNP by 1987 and 37 percent of all federal government spending, up from 25 percent in 1981. Total outlays for the six-year period from fiscal 1982 to 1987 are projected at $1.6 trillion, almost 10 times outlays in fiscal 1981. Defense spending is expanding across the board, with real increases in virtually all areas. But real purchases of defense durables—research/development and procurement of major weapon systems—will climb fastest, at 16 percent annually, between 1981 and 1987. This exceeds the heady 14 percent growth rate registered during the three peak years of the Vietnam build-up.

Forty-five percent of the $258 billion fiscal year 1983 budget authority initially sought by the Pentagon is designated for new arms—the B-1 bomber, MX-missile, C-5 transport, Trident submarines, modernized WWII battleships, and an array of other defensive and offensive airplanes, missiles and tanks. This hardware represents an increase of $28.3 billion over spending for these items in fiscal year 1982. Currently, military appropriation bills are pending in the Congress. Until then, the continuing resolution under which the Defense Department will operate until mid-December sets defense spending at an annual level of $228.7 billion.

Compared to the final Carter plan, conventional forces would grow significantly. Ground forces would receive 29 percent more M-1 tanks, 34 percent more fighting vehicles, and 25 percent more attack helicopters while the Air Force would get 15 percent more planes. The naval expansion is even larger, with the Navy targeted to gain two new nuclear-powered carriers, twice as many submarines and four battleships to be taken out of mothballs and refurbished. Nuclear deterrence will be enhanced by several satellite, missile, and bomber programs.

### Some Likely Impacts of the Military Build-up

It is difficult to project how the proposed build-up will affect inflation and relative prices, private investment, and government deficits because the effects of spending increases will depend on tax and nondefense expenditure policies and monetary policy. For instance, will accelerated defense spending be accompanied by increased tax rates or by reduced nondefense expenditures? Federal Reserve monetary policy will also affect the future course of inflation and interest rates.

Still, forecasters generally agree that U.S. production capabilities can accommodate the increased demand caused by higher defense spending. However, bottlenecks will occur in a few key defense-supplying industries.* A recent analysis by Data Resources, Inc. of the impact of the administration's defense plan notes that defense spending alternatives promise both benefits and problems:

> "Higher rates of GNP growth and lower unemployment rates can be viewed as economic benefits arising from the higher level of DOD spending, while increased inflation, higher interest rates, and larger federal deficits represent economic costs."**

This study concludes that defense spending seems unlikely to alter the fundamental direction of the economy and that changes in such measures as unemployment and interest rates emerge only after several years of revised defense spending.

The administration apparently recognizes that the macro-economic effects of government spending depend upon the mix of fiscal and monetary policies and is concerned about the flexibility of U.S. industry to respond efficiently to changing output levels implied by greater military spending. The **Economic Report** recognizes that defense spending-induced expansion of some durable goods industries may increase relative prices, that strong demand may create bottlenecks and delay the delivery of military hardware, and that defense spending hikes may temporarily crowd out private investment.

The administration claims, however, that there are solutions to the efficiency problems posed by defense spending. Better long-term planning and management of defense contracts, and more comprehensive cost estimates, can ease such problems. Agreement between the administration and Congress over the appropriate level, composition, and sources of defense funding can also help reduce any adverse impact on the deficit, interest rates, and inflation.

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* Conclusion from a symposium of five of the nation's leading forecasters "The Impact of Higher Levels of Defense Expenditures on the United States Economy in the 1980's" sponsored by the Department of Defense, October 26-29, 1980.

** George F. Brown, Jr., "Defense and the Economy: An Analysis of the Reagan Administration's Programs," **U.S. Review**, DRI, May, 1982, p. 1.18.

**Table 1.** 1980 Population and DOD Active Duty Military and Direct Hire Civilian Personnel (as of September, 1981)

| State | Population | Percent of U.S. | DOD Employees | | Total DOD Personnel | Percent of U.S. |
|---|---|---|---|---|---|---|
| | | | Military | Civilian | | |
| Alabama | 3,890,061 | 1.7 | 24,038 | 24,419 | 48,457 | 2.1 |
| Florida | 9,739,992 | 4.3 | 70,578 | 29,065 | 99,643 | 4.4 |
| Georgia | 5,464,265 | 2.4 | 62,639 | 34,509 | 97,148 | 4.3 |
| Louisiana | 4,203,972 | 1.9 | 24,564 | 8,252 | 32,816 | 1.5 |
| Mississippi | 2,520,638 | 1.1 | 19,264 | 10,499 | 29,763 | 1.3 |
| Tennessee | 4,590,750 | 2.0 | 13,029 | 7,909 | 19,938 | 0.9 |
| Sixth District | 30,409,678 | 13.4 | 213,112 | 114,653 | 327,765 | 14.5 |
| United States | 226,504,825 | 100.0 | 1,368,096 | 890,996 | 2,259,092 | 100.0 |

Source: U.S. Bureau of Census, **Census of Population, 1980** and DOD, **Distribution of Personnel by State and by Selected Locations**, March, 1982

possibly, state economies. Nationally, the impact of defense spending is diffused among states, but the impact of a few defense contracts on an individual state or community can be explosive. Defense spending certainly will set off fireworks in some southeastern communities. The southeastern corner of Georgia, for example, is being strongly affected by the biggest peacetime project in Navy history—the $1.4 billion expansion of the Kings Bay (St. Mary's) base for East Coast-based Trident nuclear submarines.

It is difficult to judge the overall regional effects of defense spending. Much of the data used to analyze economic impacts is available only at the national level. It is also difficult to determine the contract winners (recall the Lockheed-Boeing struggle to build a military transport), particularly in the fast-changing and often mobile high-tech industries that will benefit greatly from future defense spending. Nevertheless, we can piece together bits of the picture in the Southeast by examining the various dimensions of defense spending.

## DOD Personnel Spending

The relatively high concentration of armed forces based in the Southeast more than offsets the region's relatively low share of higher paying DOD civilian jobs. Georgia, which hosts almost 63,000 members of the armed forces, is home to 11.5 military personnel per 1,000 people, almost twice the nation's average. Florida, with 70,000 military personnel, hosts the largest contingent in the region. Tennessee is the only District state with significantly fewer active duty military personnel relative to state population shares (see Table 1).

Benefits to the region of this strong military representation include $4.1 billion paid annually in military salaries. These dollars typically are spent in the region, generating more employment and income. The indirect effect of defense spending is estimated to be three times greater than the value of the direct impact.[1] Thus, the $4.1 billion payroll may generate additional local spending of $12.3 billion.

In addition to the above-average receipt of active duty military pay, the region's permanent population also enjoys an above-average share of reserve and national guard pay and retired military pay. These additional payroll dollars, almost 20 percent of the national total, amount to another direct boost of $3.9 billion to the region's spending power. Finally, the concentration of military personnel **from** the region adds long-term human resources to the region via job training received in the military. As the television commercials proclaim—"it's a great place to start!"

The region's high shares in providing and hosting active duty, reserve and national guard, and retired personnel reflect a variety of social,

[1] **The Economic Effects on the Northeast-Midwest Region of Current and Potential National Defense Expenditures** (Washington, D.C: CONEG Policy Research Center and the Northeast-Midwest Institute, 1979), p. 2.

economic, and political factors. Conscious government policy to raise living standards in the South toward the national average has combined with a relatively favorable weather climate to encourage military installations to concentrate in the region. The historic shift of military facilities to southern and western parts of the country also reflects those areas' climate advantage for testing sophisticated new weapons that accompanied the post-50s shift from conventional ordnance and equipment to missiles and electronics. Southern states also have shown a greater hospitality to the military, even when support for the military was on the wane nationally. Finally, the low cost of living and other favorable characteristics of Florida, Georgia and Alabama have proven to be lures to retired military personnel.

The region's relatively large gain from spending on military personnel is not matched by civilian DOD employment, on the basis of population share. But direct hire DOD civilian jobs do add another $2.5 billion, or 12 percent of the national total, directly to the region's income stream.

On balance, spending for all DOD personnel compares favorably to the rest of the nation. In fiscal year 1981 the region's share of total DOD personnel compensation was 15.4 percent and the per capita amount received was $296 compared to $258 nationally. Florida, Georgia, and Alabama lead the area in compensation, ranking fourth, fifth, and thirteenth, respectively, among the 50 states. These rankings are important because the DOD is not only the largest federal employer, but the largest employer in the nation, with more than 2.2 million employees in 1980.

## Defense Contracts

Apart from DOD personnel compensation, the major impact of defense spending on a locality comes through business firms selling goods and services to the military. In fact, prime contracts for procurement of weapons, research and development, construction, and other material and services account for—by far—the largest defense budget increases. Thus, while there is no good reason to expect that the region's relative gains from personnel spending will decline in coming years, the major boost will come—if at all—from military business developments.

Procurement—the purchase of such hardware as aircraft, tanks, missiles, and ships—is slated to increase from 23 cents out of each defense dollar in fiscal year 1982 to over 39 cents in fiscal year 1987. In the same period, personnel compensation is scheduled to decline from 30 cents to 20 cents. This means that the primary beneficiaries of defense spending in the years ahead will be localities that produce the beefed-up U.S. arsenal.

Cities throughout the region can claim important, even spectacular, examples of military hardware suppliers. United Technologies, Litton Systems, Exxon Corporation, Martin Marietta, and Lockheed-Georgia are just a few of the industrial giants that captured huge defense contracts in fiscal 1981 (see Box 2 and Table 2).

**Florida, which ranks among the nation's leaders in electronic equipment production, seems especially favored to benefit from likely increases in weapons sophistication.**

In the future, more and more firms and the communities in which they operate will benefit from defense spending. Florida, which ranks among the nation's leaders in electronic equipment production, seems especially favored to benefit from likely increases in weapons sophistication.[2]

In fiscal year 1981 each of the southeastern states ranked among the top five nationally in at least one of the 25 major procurement programs. High rankings achieved by southeastern states were: Alabama—textiles (third), building supplies (third); Florida—weapons (second), aircraft engines (third), services (fourth); Georgia—textiles (fifth); Louisiana—petroleum (second); Mississippi—construction (second), ships (fourth), ammunition (fifth); and Tennessee—textiles (second), coal

[2]The Electronic Industries Association estimates that electronic components, as a share of the cost of all defense hardware, will jump from 40.6 percent ($22.7 billion) in 1981 to 47 percent ($106 billion) in 1991. Reported in **Business Week**, September 20, 1982, p. 76.

**Table 2.** Net Value of DOD Prime Contract Awards Over $10,000 for the Five Leading Contractors in Each State: FY 1981

ALABAMA

| Contractor | Amount | Major Product or Service |
|---|---|---|
| 1. Hayes International Corp. | $ 84,556 | Maintenance & repair of C-130 HERCULES & F-4 PHANTOM aircraft. |
| 2. Marion Corp. | 59,723 | Petroleum. |
| 3. Northrop Worldwide Aircraft Services, Inc. | 47,806 | Maintenance & repair of aircraft. |
| 4. Teledyne Brown Engineering | 45,410 | R&D, maintenance & repair of missile & space systems. |
| 5. Centre Mfg. Co. | 23,410 | Men's outerwear. |
| TOP 5 TOTAL | $260,905 | |
| STATE TOTAL | $847,752 | |
| TOP 5 AS PERCENT OF STATE | 30.8% | |

LOUISIANA

| Contractor | Amount | Major Product or Service |
|---|---|---|
| 1. Derby & Co., Inc. | $ 837,850 | Petroleum. |
| 2. Exxon Corp. | 521,963 | Petroleum. |
| 3. Houston Oil & Refining, Inc. | 228,756 | Petroleum. |
| 4. United States & South American Enterprises | 222,709 | Petroleum. |
| 5. Texaco International Trader, Inc. | 97,575 | Petroleum. |
| TOP 5 TOTAL | $1,908,853 | |
| STATE TOTAL | $3,045,133 | |
| TOP 5 AS PERCENT OF STATE | 62.7% | |

FLORIDA

| Contractor | Amount | Major Product or Service |
|---|---|---|
| 1. United Technologies Corp. | $ 892,176 | Production, components, maintenance & repair of aircraft engines; aircraft R&D. |
| 2. Martin Marietta Corp. | 540,400 | Modification of & components for PERSHING missile; munitions; R&D for missile & space systems, electronics & communications. |
| 3. Honeywell, Inc. | 187,195 | Components for B-52 STRATO FORTRESS aircraft; components for TRIDENT missile; communications equipment; R&D for electronics & communications, missile & space systems. |
| 4. Harris Corp. | 167,737 | Electronics & communications R&D; communications equipment. |
| 5. Cadillac Gage Co. | 125,036 | Armored fighting vehicles. |
| TOP 5 TOTAL | $1,912,544 | |
| STATE TOTAL | $3,169,544 | |
| TOP 5 AS PERCENT OF STATE | 60.3% | |

MISSISSIPPI

| Contractor | Amount | Major Product or Service |
|---|---|---|
| 1. Litton Systems, Inc. | $ 753,220 | Production of cruisers. |
| 2. Mason Chamberlain, Inc. | 135,555 | Operation of Government facility/ munitions. |
| 3. Tenn Tom Constructors | 68,100 | Construction/canals. |
| 4. Chevron USA, Inc. | 51,501 | Petroleum. |
| 5. Al Johnson Construction Co. | 36,940 | Construction/dams. |
| TOP 5 TOTAL | $1,045,316 | |
| STATE TOTAL | $1,442,704 | |
| TOP 5 AS PERCENT OF STATE | 72.5% | |

GEORGIA

| Contractor | Amount | Major Product or Service |
|---|---|---|
| 1. Lockheed Corp. | $628,501 | Production, components, modification, & maintenance & repair for C-5 GALAXY, C-130 HERCULES, & C-141 STARLIFTER aircraft/ |
| 2. J.P. Stevens & Co., Inc. | 28,787 | Textiles. |
| 3. Marconi Avionics, Inc. | 27,432 | Components for F-16 FALCON aircraft & AH-1S COBRA helicopter. |
| 4. Rockwell International Corp. | 25,928 | Production of HELLFIRE missile; munitions. |
| 5. Pan American World Airways, Inc. | 22,705 | Operation of Government facility/ miscellaneous. |
| TOP 5 TOTAL | $733,353 | |
| STATE TOTAL | $1,334,188 | |
| TOP 5 AS PERCENT OF STATE | 55.0% | |

TENNESSEE

| Contractor | Amount | Major Product or Service |
|---|---|---|
| 1. Martin Marietta Aluminum Sales, Inc. | $ 46,911 | Operation of Government facility/ munitions. |
| 2. Holston Defense Corp. | 42,567 | Munitions. |
| 3. Pan American World Airways,Inc. | 38,417 | Operation of Government facility/ R&D. |
| 4. Sverdrup Technology, Inc. | 30,671 | Other R&D. |
| 5. Calspan Corp. | 25,057 | Other R&D. |
| TOP 5 TOTAL | $183,623 | |
| STATE TOTAL | $521,071 | |
| TOP 5 AS PERCENT OF STATE | 35.2% | |

Source: Department of Defense, **Top Five Contractors Receiving the Largest Dollar Value of Prime Contract Awards in Each State, 1981.**

and electricity (fifth). In addition to these programs, states in the region provide sizable amounts of other goods and services to our defense establishment (see Table 3). Overall, southeastern states accounted for 11.8 percent of fiscal 1981 prime contract awards, a somewhat lower percentage than the region's 13.4 percent share of the U.S. population. All District states except Tennessee ranked in the upper half of the states in total prime contract awards, and Florida (eighth) and Louisiana (ninth) were top 10 performers among the states.

Unfortunately, prime contract data cannot measure the total volume of defense work performed within a state because a substantial amount may be subcontracted. The DOD estimates that about half of the prime contract dollars for major hard goods and unknown proportions of other types of procurement are subcontracted by prime contractors. Prime contract awards data, of course, also cannot show how the region's share of prime contracts will likely change in the future (although the region's share has tended to increase as its share of the U.S. population has increased).

One way to get a better fix on the region's true share of defense business is to adjust prime contracts for subcontracting activity. The DOD has analyzed the geographic distribution of subcontracts on prime contracts of $500,000 or more for 1979. This one-time study covered 36 percent of all large contracts and 12.4 percent of all prime contracts. The region's share of large contracts for the study year more than doubled, from 5.5 percent to 12 percent, when the initial amount of large prime contracts awarded to a state was adjusted for gains and losses due to interstate subcontracting. Virtually all of the gain

**BOX 2**

**LOCKHEED-GEORGIA AND THE C-5 — THE COMMUNITY IMPACT OF A LARGE DEFENSE CONTRACT**

Lockheed-Georgia (L-G) Company, based near Atlanta in Marietta, recently won a major battle to provide the Air Force with new transport planes. Although contract negotiations are not yet complete, suppose Lockheed signs a contract on December 31, 1982 to provide the Air Force with 50 planes over the next seven years for $4.6 billion (in 1980 dollars), as proposed. What will be some of the major effects of the contract on the Atlanta area?

**Jobs.** L-G currently employs about 13,000 workers and is the largest private employer in the Atlanta metropolitan area. Most of these workers live in the Atlanta area, although some commute a long distance; workers from 64 of 159 Georgia counties are on L-G's payroll. By early 1985, about a year before the first plane is delivered to the Air Force, L-G's work force will have expanded by 6,000 to 8,000, raising total employment to 20,000. In 1983, the first year of the contract, highly skilled engineers and computer specialists will hire on for the design phase of the plane-building. About 18 months later, thousands of structure assemblers will begin fabrication of the plane. As these workers at the plant increase, the service/support staff—secretaries, guards, nurses, training personnel, inspectors—will also expand significantly. While some of the skilled specialists will be drawn from outside the state, most of the work force additions will come from Georgia.

**Income.** L-G's current work force earns about $7 million per week. Roughly, that figure will rise to more than $10.5 million (in today's dollars) when all the additional workers are on the payroll. Their average weekly earnings will be much higher than average weekly earnings in total manufacturing or other important manufacturing industries in the area. As workers spend this income on goods and services, additional jobs and income will be generated, providing more of a boost to the area's economy.

**Subcontracting.** A reasonable guess is that half of the prime contract's value will be subcontracted to numerous suppliers throughout Georgia, the Southeast and the nation. Local firms supply the gamut of business goods and services required by Lockheed as well as components for the planes. One-third of L-G's total subcontract awards in 1981 went to Sixth District states plus the Carolinas. AVCO, in Nashville, Tennessee, is the largest subcontractor in the region; it built the modified wings on 77 C-5As, the predecessors of the new C-5Bs. As production of the C-5B proceeds, the current share of subcontracts to southeastern states will likely fall somewhat because some major components can be obtained only from outside the region—the jet engines, for example, are produced by General Electric in Ohio.

**Other Community Benefits.** L-G's size also means the company pays a large property tax bill and is a heavy user of public utility services. The company paid $2.3 million in property taxes in 1981, while its phone bill was $1.5 million and it purchased $7 million in fuel, electricity, and water. The company's size and purchasing power may also be contributing to the location and expansion of high-tech firms in the Atlanta area.

**Table 3.** Top 5 Procurement Programs and Total Prime Contract Awards by State for Fiscal Year 1981

| Procurement Programs | Value (thousands) | Percent of United States |
|---|---|---|
| Alabama | | |
| Military building supplies | 9,687 | 11.5 |
| Textiles, clothing and equipage | 80,119 | 9.4 |
| Other aircraft equipment and supplies | 76,727 | 2.1 |
| Construction equipment | 92,604 | 1.9 |
| Subsistence | 29,679 | 1.8 |
| Total Contracts | 847,752 | 1.0 |
| Florida | | |
| Aircraft engines and rel. spares | 882,336 | 17.3 |
| Weapons | 123,557 | 7.3 |
| Services | 354,213 | 5.0 |
| Other aircraft equipment and supplies | 146,207 | 3.9 |
| Subsistence | 63,588 | 3.9 |
| Construction | 194,803 | 3.9 |
| Total Contracts | 3,169,443 | 3.6 |
| Georgia | | |
| Textiles, clothing and equipage | 67,933 | 7.9 |
| Air frames and rel. assemblies and spares | 563,989 | 5.5 |
| Construction | 240,577 | 4.9 |
| Subsistence | 47,151 | 2.9 |
| Other aircraft equipment and supplies | 92,381 | 2.5 |
| Total Contracts | 1,334,188 | 1.5 |
| Louisiana | | |
| Petroleum | 2,527,080 | 26.7 |
| Construction | 232,484 | 4.7 |
| Military building supplies | 1,527 | 1.8 |
| Services | 84,164 | 1.2 |
| Subsistence | 18,090 | 1.1 |
| Total Contracts | 3,045,133 | 3.5 |
| Mississippi | | |
| Ships | 756,848 | 9.7 |
| Construction | 305,224 | 6.2 |
| Ammunition | 135,543 | 5.8 |
| Non-combat vehicles | 35,354 | 3.9 |
| Textiles, clothing and equipage | 29,088 | 3.4 |
| Total Contracts | 1,442,704 | 1.6 |
| Tennessee | | |
| Textiles, clothing and equipage | 82,357 | 9.6 |
| Ammunition | 109,062 | 4.7 |
| Other fuels and lubricants | 4,229 | 4.3 |
| Services | 153,309 | 2.2 |
| Subsistence | 29,366 | 1.8 |
| Total Contracts | 521,071 | .6 |
| Sixth District | | |
| Total Contracts | 10,360,291 | 11.8 |
| U.S. | 87,761,215 | — |

Source: Department of Defense, Prime Contract Awards by Region and State, 1979, 1980, 1981.

**Table 4.** 1979 Geographic Distribution of Subcontracts

| | Total Reported | Percent Total U.S. Reported | Net Total Reported | Percent U.S. Net Total Reported |
|---|---|---|---|---|
| Alabama | 4,416 | .05 | 23,365 | .26 |
| Florida | 285,909 | 3.25 | 942,035 | 10.71 |
| Georgia | 42,514 | .48 | 15,362 | .17 |
| Louisiana | 0 | 0.00 | 2,963 | .03 |
| Mississippi | 110,086 | 1.25 | 53,423 | .61 |
| Tennessee | 26,309 | .30 | 15,621 | .18 |
| Total District | 469,234 | 5.33 | 1,052,769 | 11.97 |
| Total U.S. | 8,794,432 | 100.00 | 8,794,432 | 100.00 |

Source: DOD, **Geographic Distribution of Subcontract Awards, Fiscal Year 1979**, August, 1980.

in the region, moreover, went to Florida (see Table 4), which apparently received about $730 million in subcontract awards from Massachusetts.[3]

An alternative view of the impact of defense spending is provided by looking at the total value of shipments and employment relating to these shipments by manufacturing firms that sell to the DOD. For 1980, data show that employment associated with defense contracts in the Sixth District states accounted for a smaller share of total national employment in 92 selected industries, 6 percent (Table 5), than the District's 7 percent share of all employment. Furthermore, the District's share of such employment had fallen from 7.6 percent in 1968.

Within the region, Florida is unique in showing a rapid **increase** in its share of defense-related employment. In 1968, Florida's share of U.S. defense employment, 2.1 percent, exceeded its overall 1.2 percent share of employment in the surveyed industries. Georgia, with 2.7 percent of the defense employment, also exceeded its overall 1 percent share of all employment in the surveyed industries. By 1980, Florida's share of the nation's work force had risen to 3.2 percent, or 1.1 percent more than its overall share of workers in the surveyed industries. Meanwhile, Georgia's share of defense workers **declined** about 2 percent although it reported the same total share of workers.

Workers producing for defense in the surveyed regional firms in 1980 totaled 44,500; in 1968, the comparable number was almost 100,000. The reason for the sharp decline, of course, is that 1968 marked the peak year of the Vietman conflict military build-up while 1980 followed a decade of falling real spending on defense. That wind-down also provides an important explanation for Georgia's shift from a relatively high concentration of defense workers to a relatively low concentration. Lockheed-Georgia employment peaked at over 30,000 workers in 1969 as the firm turned out C-5 cargo planes. By 1977, its employment had declined to a record low 8,852 workers and corresponded to the 1970s' trough in defense spending.

The 44,500 jobs generated by defense contracts in surveyed industries in the region in 1980 does **not** represent its total employment from defense contracts. Several important southeastern manufacturing industries—food, tobacco, textiles and apparel, lumber and wood products, furniture, and paper—are excluded from the shipments survey. In many instances, District states have

[3]Lynn E. Browne and Sarah Gavian, writing in the Federal Reserve Bank of Boston's **Economic Indicators**, "The Importance of Defense to New England," October 1981, note that the subcontracting report "raised as many questions as it answered and was discontinued after one year" and that the "large net outflow (from Massachusetts) seems unlikely given the technological content of today's weapon systems and Massachusett's preeminence as a center of high technology." They also argue that the outflow is also not consistent with data on shipments from states to the DOD. However, the DOD shipment data do show that Florida shipped 2.5 percent more than Massachusetts to the DOD in 1979, whereas Massachusetts received 70 percent more than Florida in total prime contracts and over 600 percent more of the large prime contracts in the subcontracting survey. It is thus likely that Florida did receive a significant amount of subcontracts from Massachusetts.

**Table 5.** Total Defense Employment and Value of Shipments to DOD*

| | 1980 | | | | 1968 | | | |
|---|---|---|---|---|---|---|---|---|
| | Employees (000) | | Shipments ($ millions) | | Employees (000) | | Shipments ($ millions) | |
| Alabama | 5.8 | (.8) | 260.8 | (.5) | 8.0 | (.6) | 121.1 | (.4) |
| Florida | 23.7 | (3.2) | 1,236.5 | (2.6) | 27.8 | (2.1) | 600.1 | (1.8) |
| Georgia | 5.5 | (.7) | 423.5 | (.9) | 35.0e | (2.7) | 750.0e | (2.2) |
| Louisiana | 3.2 | (.4) | 456.2 | (.9) | 3.0 | (.2) | 130.4 | (.4) |
| Mississippi | .9 | (.1) | 48.2 | (.1) | 7.5e | (.6) | 75.0e | (.2) |
| Tennessee | 5.4 | (.7) | 283.6 | (.6) | 17.4 | (1.3) | 323.8 | (1.0) |
| District | 44.5 | (6.0) | 2,708.8 | (5.6) | 98.7 | (7.6) | 2,000.4 | (6.0) |
| U.S. | 743.6 | (100.0) | 48,237.7 | (100.0) | 1,300.3 | (100.0) | 33,441.9 | (100.0) |

*Number in parentheses is the percent share of U.S.

e - estimated

Source: U.S. Bureau of Census, **Shipments to Federal Government Agencies, 1980,** MA-175(80)-1, November, 1981 and U.S. Bureau of Census, **Shipments of Defense-Oriented Industries, 1968,** MA-175(68)-2, November, 1970.

captured a disproportionately high share of defense contracts for these goods. A similar situation exists in some major nonmanufacturing sectors—for example, agriculture, mining, and construction. If employment associated with the non-surveyed manufacturing industries and other economic sectors is included, then perhaps 170,000 of the region's workers produce goods and services for defense.[4] Total defense employment then would equal about 1.5 percent of the region's employed workers. Alternatively, the 170,000 workers represent 10 percent of all nonfarm employment in Tennessee in 1980 or more than one-third of the farm workers in the region.

## Future Impact of Increased Defense Spending

So far, little has been written regarding the effect of increased military spending on future employment and income in the region. However, the importance of military spending to the region now suggests that such increased spending will grow in importance in the future. Whether the Southeast will benefit disproportionately is much more difficult to answer.

One way to glimpse the impact of defense spending in coming years is to identify industries likely to be most affected by rising defense spending and to compare recent changes in the region's share of the nation's employment in those industries. Computer simulations indicate that fabricated metal products (including ammunition and ordnance), electrical machinery (communications equipment), and transportation equipment (aircraft, shipbuilding, tanks, and missiles) are key defense-supplying industries projected to grow well in excess of the rest of the economy.[5]

Southeastern states host an increasing share of industries likely to show the fastest growth nationally during the next five years. Electronic equipment, transportation equipment, and fabricated metals industries have increased their shares of southeastern states' manufacturing employment from 6.3 to 8.6 percent, 5.5 to 5.7 percent and 7.6 to 7.9 percent, respectively, in recent years. As a consequence of their relatively faster regional versus national growth, these industries' relative concentration of regional

[4]This figure is derived by applying the employment-to-shipments ratio to total prime contracts received, a crude technique that may miss the true employment figure by a wide margin in either direction.

[5]DRI, **op. cit.**, p. 1.21.
It is noteworthy that the losses in factory jobs in the current recession have been particularly heavy in the major metals and metal-using industries. These industries, which include primary and fabricated metals, electrical and nonelectrical machinery, and transportation equipment, have accounted for over half of the declines in nonfarm payroll employment in the nation and the Southeast since the pre-recession peak in July 1981. The reduction in industrial production indexes and capacity utilization in these industries, which mirror the job losses, suggests the presence of adequate industrial capacity for at least the initial years of the military build-up.

**Table 6.** Employment Shares and Specializations* in Key Defense Industries

| | Electrical Machinery | | | | Fabricated Metal Products | | | | Transportation Equipment | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Manufacturing | | Specialization | | Manufacturing | | Specialization | | Manufacturing | | Specialization | |
| | 1972 | 1978 | 1972 | 1978 | 1972 | 1981 | 1972 | 1981 | 1972 | 1981 | 1972 | 1982 |
| Alabama | N.A. | N.A. | N.A. | N.A. | 6.5 | 7.0 | .81 | .89 | 1.6 | 6.4 | .60 | .71 |
| Florida | 9.3 | 13.0 | .98 | 1.34 | 8.0 | 8.4 | .99 | 1.07 | 10.8 | 13.4 | 1.16 | 1.48 |
| Georgia | 2.8 | 6.5 | .30 | .67 | 3.8 | 3.8 | .47 | .49 | 7.2 | 6.9 | .77 | .76 |
| Louisiana | 3.6 | 5.4 | .39 | .56 | 7.4 | 8.4 | .92 | 1.08 | 11.6 | 13.4 | 1.25 | 1.47 |
| Mississippi | 7.7 | 9.5 | .81 | .98 | N.A. | N.A. | N.A. | N.A. | 11.4 | 9.6 | 1.22 | 1.06 |
| Tennessee | 7.9 | 8.1 | .83 | .84 | 6.4 | 6.3 | .79 | .80 | 4.0 | 4.4 | .43 | .49 |
| Sixth District | 6.3 | 8.6 | .66 | .89 | 5.5 | 5.7 | .68 | .73 | 7.6 | 7.9 | .82 | .87 |
| U.S. | 9.5 | 9.7 | — | — | 8.1 | 7.8 | — | — | 9.3 | 9.1 | — | — |

Source: U.S. Department of Labor, **Employment and Earnings.**

*A state's specialization (or "location quotient") is the ratio of the state's employment in an industry to the corresponding employment in that industry in the nation. As an example, the specialization of the District in transportation equipment in 1981 was derived by dividing 7.9 by 9.1. (In 1981, the U.S. transportation equipment industry accounted for 9.1 percent of the nation's total manufacturing employment while 7.9 percent of the region's manufacturing employment was engaged in the same industry.)

employment in these industries compared to the nation is also rising. However, only Florida, Louisiana, and Mississippi currently specialize in these industries (Table 6).

Florida leads the region's states in employment in these rapidly growing industries with relatively high shares of workers in all three.

**Southeastern states host an increasing share of industries likely to show the fastest growth nationally during the next five years.**

Louisiana also specializes in fabricated metals and transportation equipment and Mississippi has a specialization in transportation equipment. While the other states in the region presently have no relative employment concentration in any of these three industries, they have generally increased their participation compared to the rest of the nation.

The extent to which the southeastern states continue to gain "market share" of the fast-growing industries depends on a continuation of recent trends. Clearly, simple extrapolation from the past into the future is hazardous. Nevertheless, continued migration of business firms to the Southeast, particularly of high-technology firms to places like central Florida, Atlanta, and Huntsville, promises that the region will continue its gains in important industries. Also, if the experience of the Vietnam build-up provides a useful guide, shipbuilding firms in Louisiana and Mississippi, aircraft firms in Georgia and Florida, munitions factories in Tennessee, and maintenance shops in Alabama should more than hold their own in competition for defense dollars.

## Further Thoughts on Defense Spending

Although many issues have yet to be resolved, it seems clear that benefits will accrue to the Southeast from higher defense spending. Defense contracts should prove a source of growth over the next half decade. Yet, increased defense spending is not without its problems, and uncertainties abound over its impact.

Because of the potentially dramatic impact of defense spending on certain states and localities, some areas that appear to be winners

might find the future littered with unseen land mines. Potential consequences include unforeseen employment drops from nondefense spending cuts and unexpected shortages or surpluses of workers in different industries.[6] Some studies have found that military spending generates fewer jobs per dollar than nondefense spending.[7] Defense production is less labor-intensive than, say, spending on health or education. The labor force in defense-associated industries generally is more skilled than the labor force as a whole.[8] In the fastest-growing industries associated with increased defense spending—aircraft, communications equipment and ordnance—10 percent of the employees are engineers compared to only 1 percent in the overall economy. Thus, higher defense spending may entail a substantial shift in the composition of employment in some localities.

These findings reinforce the administration's concerns voiced in the **Economic Report of the President** (see Box 1). The defense build-up may cause private buyers to pay more for goods from some industries producing for defense or lead others to cancel or postpone plans for expansion because of shortages of production equipment. States in the region—Florida, in particular—will stand a better chance to capture the full potential gains from defense spending if they create early warning systems to identify the negative impacts and develop policies to lessen the magnitudes of these impacts.

**—William J. Kahley**

*Note: Theresa Grubbs contributed valuable research assistance in the preparation of this article.*

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[6]A startling illustration of the uncertain impact of the proposed defense spending increases is a study by California's Office of Economic Policy, Planning and Research titled **The Effect of Increased Military Spending in California** (unpublished mimeo, May 19, 1982). The importance of defense spending to California's economy is clearly greater than to the total U.S. economy. In 1980, California captured 19.3 percent of all DOD obligations to fund military contracts and 14.8 percent of payroll obligations. Furthermore, the projected growth of military spending is most significant in industries in which California historically has had a large share of production. Yet. the study concludes that "California is not the winner that many assume it is," and the cautions raised may help us to understand what lies ahead for Florida and other states in the region.

The California study recognizes that defense spending projections would create many new jobs. However, it notes that:

> ". . .the increases in employment as a result of incremental military spending may barely offset the employment losses resulting from nondefense budget cuts. If the Reagan administration is successful in obtaining additional budget reductions currently under consideration, California will actually lose jobs due to the budget shuffling."

The study concludes that even if the net change in state employment is small, the pluses and minuses will be quite large in some industries. Furthermore, in the fastest-growing industries it is doubtful that California will be able to attract the skilled personnel needed without bidding up wages in already tight markets for engineers and other skilled workers.

[7]See W. Leontief and M. Hoffenberg, "The Economic Impact of Disarmament," **Scientific American**, April 1961; U.S. Department of Labor, Bureau of Labor Statistics, **Projections of the Post-Vietnam Economy,** 1975 (1972); **Time** (March 22, 1982), p. 51.

[8]See Max A. Rutzick, "Skills and Location of Defense-Related Workers," **Monthly Labor Review**, February 1970.

# Shared ATM Networks: The Nation and the Southeast

**Banks are struggling to find a balance between competition and cooperation in the payments system. The race for control of ATM networks is heating up.**


Slow to leave the starting gate, automated teller machines (ATMs) now lead the pack of new, electronically delivered banking services playing a major role in today's financial services revolution. The number of ATMs in operation in the United States is expected to reach 25,000 by year-end 1982[1] and each machine today is processing an estimated 7,200 transactions a month including balance inquiries.[2]

The explosion in ATM popularity has led financial institutions with ATM networks to seek new ways to benefit from their investment in the technology. It has led others, such as the bankcard associations, ATM hardware and software vendors, supermarkets, and even individuals to search out profit opportunities in the field. And it has led smaller financial institutions to find cost-justifiable ways of providing ATM services to customers as a way of maintaining their positions in the competitive fray.

All of this exploration of ATM opportunities has produced a new race—the race for leadership in nationwide ATM interchange. The sharing of ATM networks at the national level is an extension of the sharing taking place in local and regional markets. It reflects a maturation of early ATM systems and the banks' changing ATM objectives that have accompanied that growth. It also indicates that barriers to interstate banking are under attack. Just as financial institutions used local and regional shared networks to get around state branching regulations, many are using shared nationwide networks as a first step in positioning themselves for interstate banking when geographic restrictions are lifted.

The Southeast is a relative newcomer to the ATM sharing arena. The competitive environment and branching regulations in the six states that constitute the Sixth Federal Reserve District[3] favored the development of proprietary—rather than shared—ATM networks. However, the possibility of interstate banking is affecting banks in the Sixth District, one of the highest growth markets in the country. The nationwide sharing phenomenon has prompted some sharing initiatives in the Southeast.

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[1]Payment Systems, Inc., "Consumer Survey-Payments Perspectives '82", (Atlanta, Georgia 1982) pp. vii.

[2]Linda Zimmer, "ATMs: Time to Fine-Tune and Plan," **The Magazine of Bank Administration**," May 1982, pp. 21.

[3]The Sixth Federal Reserve District comprises all of Alabama, Florida, Georgia and parts of Mississippi, Louisiana and Tennessee. In this article these states are also referred to as the Southeast.

Nationwide ATM networks permit customers to gain direct access to their accounts at home even when they travel. More importantly, networks provide the infrastructure for other electronic banking services. The jockeying for position among nationwide ATM networks is early evidence of a battle among banks, major bankcard associations and nonfinancial organizations for leadership in the total electronic payments system that is still in its formative phase. It remains to be seen whether financial institutions can cooperate in developing bank-controlled electronic payments networks that will allow them to distinguish themselves from bank competitors in their primary markets and to meet customers needs. If banks fail to find a balance between competition and cooperation, others, such as retailers, could develop and control the systems, and banks would have to purchase access to those systems.

At the individual financial institution level, economic and competitive factors first influence ATM system design. As networks expand geographically and involve more than one financial institution, legal and regulatory issues help shape ATM developments. Shared systems at the nationwide level are influenced by all these factors and more. The alternative approaches to nationwide sharing reflect different viewpoints on the role that banks and the banking industry should play in the future payments system.

## Institutions' Objectives for ATMs

ATM network design begins at the institutional level. Before deciding to install ATMs or to join a shared ATM network, financial institutions must first identify their ATM objectives. These vary from bank to bank and depend on location, customer make-up, portfolio, competitors, and so forth. The objectives also are influenced by a wide range of external forces. Changing consumer preferences and technological advancements may lead an institution to install ATMs to enhance its image as a progressive, innovative organization. Banks in limited branching or nonbranching environments might implement ATM programs to extend their geographical market ranges. Another objective might be to control escalating labor and occupancy costs. Finally, confronted with continuing financial industry deregulation and the uncertainty of changing markets and competitors, institutions may adopt ATM programs for defensive or long-range positioning reasons or to preempt choice sites, such as airports or convention centers, where high transaction volumes might be anticipated to generate substantial transaction and interchange fee income.

Regardless of the circumstances, ATM objectives generally are expressed in both market and financial terms. A recent study suggests that the relative importance of objectives changes over time. Table 1 shows the results of a survey of commercial banks offering ATM services. The objectives of banks just getting into ATM services are somewhat limited in scope. Most banks starting ATM networks after 1980 named two predominant objectives. Fifty-two percent had defensive objectives (market-share retention), and 76 percent cited reduced lobby traffic as an important ATM goal. Financial institutions with networks older than two years perceive them as competitive weapons that can be actively promoted to increase market share. In addition, the financial objectives—reducing costs and generating income—come to the fore.

**If banks fail to find a balance between competition and cooperation, others, such as retailers, could develop and control the systems, and banks would have to purchase access to those systems.**

Cost reduction may become even more important in the mid 1980s. Recent cost estimates for ATM systems versus traditional teller systems demonstrate the potential for cost savings. In 1986 off-line teller transaction costs are forecast to reach 82 cents per transaction. For on-line teller transactions the estimate is 48 cents, and the cost per transaction is projected to be only 28 cents for ATMs.[4] These cost differentials demonstrate the savings from less paper processing,

[4]Based on a melding of several IBM studies with banks on the economic justification of branch automation, ATM installation and point-of-sale automation-cited by Donald Long in "The Business Case of Electronic Banking," **Journal of Retail Banking**, June 1982, pp. 19.

**Table 1.** Impact of Network Maturation on Management Objectives
Percent of Institutions Setting Various Objectives

| | Total | <1975 | 76-77 | 78-79 | >1980 |
|---|---|---|---|---|---|
| Increased Market Share | 40% | 83% | 73% | 44% | 40% |
| Defensive | 41% | 31% | 41% | 44% | 52% |
| Cost Reduction | 36% | 42% | 36% | 44% | 20% |
| Branch Reductions | 26% | 46% | 14% | 19% | 28% |
| Reduced Lobby Traffic | 70% | 66% | 73% | 81% | 76% |
| Other | 26% | 31% | 27% | 22% | 24% |

Source: Bank Systems and Equipment, December 1981, p. 96.

reduced or contained personnel costs, and reduced facilities costs from fewer brick-and-mortar branches.

Income is a mature ATM-network objective. Customers of mature networks are willing to pay for ATM services they have become accustomed and attached to. This has allowed operators of networks to charge fees for ATM services without losing many customers. ATMs also can increase income via larger average balances and greater market share. Furthermore, the market segment attracted to ATM services is highly desirable. A recent survey by Payment Systems, Inc. (PSI) showed that ATM users tend to be affluent customers with upscale jobs and education—and with higher average balances.[5]

These customers are also likely to accept other electronic payment services when they are introduced. For example, 63 percent of the PSI survey respondents who cited ATMs as an important factor in selecting a bank also showed interest in in-home banking. Building customer relationships is an objective incorporating plans for future services. It may not be an immediate ATM objective for institutions just entering the market, but its importance is increasing and will continue as interest in other electronic payment services grows in the late 1980s and early 1990s.

## ATM Network Structures

Having identified its short and long-term objectives, a financial institution must also consider whether or not to share. There are valid arguments for and against ATM sharing, and there are many ways to structure such networks if an institution decides to share. Some alternatives include:

- Operating a proprietary ATM network;
- Selling a proprietary network on a wholesale basis to correspondent banks;
- Franchising a proprietary network;
- Entering into joint ventures with other financial institutions to operate a shared network of ATMs; and
- Participating in a shared ATM network operated by a third-party vendor.

**Proprietary networks.** Operating a proprietary network is a straightforward choice. A financial institution purchases or leases automated teller machines, acquires the necessary software or develops it in-house, installs the system and markets it, issuing cards of its own design. Advantages of a proprietary system are that the institution maintains complete control of the system and its services, and the product is

[5]Payment Systems, Inc., *op. cit.* Table 31.

identified with only one institution. The disadvantages are that implementing and marketing an ATM network is costly, the volume of transactions is limited by the size of the institution's cardholder base, and there may be a very long payback period. In short, the proprietary ATM network is likely to have excess capacity that could be put to work profitably.

An institution can develop additional transaction volume, improve profitability and extend its geographic range by selling its ATM services to downstream correspondent banks. It can recover the cost of any additional ATMs by leasing them to the correspondent banks. It can generate revenue by issuing cards to correspondent banks' customers and by processing their ATM transactions. Yet it does not give up control. While the ATM network identity may be somewhat diluted because correspondent banks' customers associate it with their own banks, the product remains identified with the proprietor bank in its own market. Furthermore, the bank enhances the convenience for its customers by making its ATM product available in other market areas where they would not otherwise have access to their bank.

Another way in which an institution can use excess capacity and generate revenue is to franchise its ATM product. This is a way to recover some of the development costs of a proprietary ATM network without necessarily giving other institutions' customers access to the proprietor's ATMs. If the franchise agreement requires the franchise operation to get its ATM transaction processing from the lead bank, the originator of the service can earn fee income while the increased volume reduces its marginal costs. Like wholesaling, franchising may dilute the identity of the ATM service name as an unique product. However, by offering the franchise in selected markets and preparing to facilitate interchange among the franchised ATM operations, the lead financial institution may position itself for later entry into those markets.

**Shared ATM networks.** Sharing occurs when customers of one or more financial institutions have access to one or more transaction services at ATMs owned or operated by other financial institutions. Technically, then, a proprietary ATM service marketed to downstream correspondents is a kind of shared ATM network. It falls under the heading of proprietary networks, however, because of the issue of control. While a wholesale ATM network may be responsive to the needs of correspondent banks, the decision-making process is controlled by the wholesale financial institution. Banks participating in other kinds of shared ATM systems also forego some of the decision-making power inherent in proprietary systems. They may also give up the benefit of product differentiation, the unique identification of their ATM service as a product of their bank. On the other hand, they are able to provide ATM services to customers without bearing the total burden of development and operating costs.

An alternative to participating in a wholesale ATM network is a joint venture with other financial institutions. The joint venture's organizational structure and specific details of the ATM network operation are determined by the participating banks. They may determine jointly the kind of ATMs they will deploy, whether the ATMs will be individually or jointly owned, the particular software package to acquire or develop, whether the switch (the mechanism that directs the ATM transaction to the cardholder's financial institution) will be "in front" or "in back" of the bank,[6] and the pricing structure for interchange transactions made by one bank's customers at another bank's ATM. Details that must be worked out to implement an ATM network are numerous, and each shared system based on the joint-venture model may be unique in some ways. Nevertheless, all have in common the key features of shared access and cooperative control.

Third-party ATM networks provide yet another avenue into the ATM marketplace. Service bureaus, hardware vendors and software specialists are all marketing ATM processing, switching and other technical support to financial institutions today. Third parties can be quite flexible in what they offer. Their ATM-supporting services might run the gamut from issuing cards only through data processing for proprietary networks and switching for local shared services, to linking their service users together in a nationwide ATM interchange network. Third parties, in the business of selling technology,

[6]When the switch is "in front" of the bank, the transaction is routed from the ATM directly to the customer's bank. When it is "in back" of the bank all transactions go first to the ATM-owning institution, which pulls out its own customer's transactions and then switches other bank customers' transactions to the appropriate banks.

are interested in taking a leading role in the operation of the emerging electronic payments system. They are not necessarily interested in becoming banks in the traditional sense. Their technical support may be the advantage that influences one institution's decision to enter the ATM market via the third-party route. Another institution may fear that giving a nonbank third-party processor a substantial role in the payments system will pose a threat to its future growth.

Clearly, the factors that influence institutions' ATM decisions are reflected in the network structures themselves. Unshared proprietary networks offer product differentiation and identity in the marketplace, while shared networks promise economic advantages such as the potential for fee income and recouping or spreading product development and operating costs. The choice of an appropriate sharing structure is influenced by banks' philosophies on the issue of control and by their longer-term strategic goals. In addition, legal and regulatory factors have played a major role in the development of shared ATM networks.

**Third parties, in the business of selling technology, are interested in taking a leading role in the operation of the emerging electronic payments system. They are not necessarily interested in becoming banks in the traditional sense.**

## The Influence of Regulation and Legislation on ATM Sharing

Many of today's shared ATM systems arose as a result of state legislation. The arrival of electronic funds transfer (EFT) services raised a number of federal antitrust issues. Questions concerned the ability of all financial institutions to enter and compete in an EFT market environment, the accessibility of EFT services to all consumers, and the potential for discriminatory pricing practices. The antitrust issues led to mandatory sharing provisions in the EFT laws in 24 states.[7] In these states a financial institution must share its off-premise ATMs with any financial institutions that request shared access. Mandatory sharing protects small financial institutions by enabling them to deliver services similar to those of larger banks. While it may also have the perverse effect of discouraging larger institutions from deploying off-premise ATMs that smaller competitors would be free to share at little cost or risk, this does not appear to have occurred. Perhaps the incentive for fee income from transaction interchange is greater than competitive concerns.

EFT legislation in other states varies. Alternative legal environments offer such options as:

- Permissive/nondiscriminatory sharing, in which a financial institution can choose to operate a proprietary network (that shares with no one). However, if it does share, it is required to share with all.
- Permissive sharing, in which the financial institution may or may not share.
- Pro competitive sharing, in which a case-by-case analysis of the competitive impact determines whether a financial institution must share.

State branching regulation also has influenced many banks' decision to share ATMs. When most ATMs were being installed in branch locations, the power of proprietary ATM networks to provide additional convenience and attract new customers was less substantial in unit banking and limited branching states than in states with liberal branching laws. In states with restrictive branching laws, sharing offered a way for banks to extend their geographic market range. One recent study has shown that shared systems in unit and limited branching states outnumber those in statewide branching states 24 to 6.[8]

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[7]Theresa A. Einhorn, "EFT and the Law," **The Southern Banker**, October 1982.

[8]Payment Systems, Inc., *op. cit.*, p. 55.

## ATM Networks in the Southeast

Most of the six states in the Sixth Federal Reserve District have relatively liberal laws regarding branching and multibank holding companies and none has mandatory sharing provisions for ATMs. Prior to 1978, there was little incentive for southeastern financial institutions to develop shared ATM networks. Until that time, consumer acceptance of ATM services was an open question, and the number of ATMs in operation in the nation grew slowly. ATM growth was slow in the Sixth District, but it picked up substantially from 1978 through 1982.

Geographically, ATM growth has been concentrated in Georgia, Florida and Tennessee, with Florida leading the way. Much of that growth may be attributed to the number of densely populated SMSAs in these states and to their highly competitive environments. Early customers of ATM services generally were young, well-educated, upscale consumers living in SMSAs. Big city banks competed strenuously to attract these customers.

In the Sixth District, shared ATM networks emerged slowly. Apparently, large southeastern financial institutions did not see shared ATMs as a necessary vehicle to improved market location. The larger banks and multibank holding companies already had, or were actively developing, networks of branches and subsidiaries in choice locations by 1978 and had little to gain in terms of market access from ATM sharing arrangements. Instead, they followed a strategy of placing ATMs in their established branch and subsidiary banks. They concentrated on competitive objectives, using their ATMs to gain or retain market share. Some banks also promoted alternative products that competed with ATMs, such as check authorization and guarantee. Although a variety of ATM network structures now exist in the Southeast, the number of ATMs in proprietary networks far outnumber those in any other type of arrangement. One of the largest proprietary networks in Florida comprises more than 150 ATMs, for instance, and one in Georgia has more than 80 machines.

Not all larger banks in the region have maintained a strictly proprietary stance. First Tennessee Bank is one institution that has charted a different course. First Tennessee owns and operates the "Money Belt," a proprietary network offered to correspondent banks in Alabama, Arkansas, Mississippi and Georgia as well as in Tennessee. "Money Belt" supports interchange among the correspondents and with First Tennessee, an attractive arrangement for smaller banks.

**Geographically, ATM growth has been concentrated in Georgia, Florida and Tennessee, with Florida leading the way.**

The "Money Belt" network is an extension of First Tennessee's correspondent services line. The bank offers a variety of data processing services, including the Money Belt," to its correspondents. The bank thus has a complete service package that many small banks (under $100 million in deposits) cannot afford on their own. First Tennessee estimates the potential market for their package of services at about 700 banks.

Georgia Express is a similar shared ATM network based in Georgia. Technically, Georgia Express is a third-party network. It is operated by First Financial Management Corporation, a service bureau subsidiary of First Railroad Banking Corporation. Presently Georgia Express offers ATM cash withdrawal services to 26 banks in 45 Georgia cities on an interchange basis.[9] Most participating banks are small, with total deposits averaging $48 million. Although the service is presently limited to Georgia, First Financial Management provides on-line data processing to 165 banks in Georgia, Alabama and Florida. Thus the potential exists for Georgia Express to go interstate.

Georgia Express and Money Belt are not the only organizations in the region offering ATM services to smaller financial institutions. They are, however, the most fully developed programs being marketed today. Other southeastern banks that offer ATM services to respondents and small,

[9]Telephone conversation with First Financial Management representative, September 1982.

out-of-market competitors include Citizen and Southern and Trust Company, two of Atlanta's leading banks.

Apparently, wholesale ATM services are becoming an important component of the correspondent banking strategy of Sixth District commercial banks. Smaller banks need these services, and because of escalating labor costs they will continue to need them. As long as larger banks can deliver these services at attractive prices, both sides of the correspondent relationship can gain from the economies of larger volume processing. In addition, downstream sharing is a source of fee income, generated from ATM interchange, that the banks are beginning to tap. This income potential seems likely to continue growing as consumers in non-SMSA areas follow the lead of city dwellers and begin to view the convenience of ATM services as an essential banking need.

**It is difficult to conceive of a customer establishing a transaction deposit account (checking or NOW account) with an out-of-state bank whose only presence in the customer's community was an ATM.**

Two shared ATM networks that operate in Louisiana, MPACT and Pulse, differ from those elsewhere in the Southeast. Larger banks that often compete in the same market area participate in MPACT and Pulse. However, MPACT and Pulse are regional ATM networks based in Texas, and the leading financial institutions in the systems are Texas banks. MPACT and Pulse evolved in Texas in response to that state's unit banking and mandatory sharing laws.

It is too early to determine the effect that MPACT and Pulse will have on ATM sharing developments in the Southeast. However, their extension into Louisiana apparently relates more to the natural market area for these Texas-based regional systems than to a major effort to extend the scope of their activity geographically. Each of these networks has already announced ties to one of the emerging nationwide networks.[10]

## Nationwide ATM Networks

The prohibition against interstate banking is inducing the development of nationwide ATM networks, although much of this influence may be indirect. Specifically, the prohibition is against taking deposits across state lines. Even if there were no legal constraints, it is difficult to conceive of a customer establishing a transaction deposit account (checking or NOW account) with an out-of-state bank whose only presence in the customer's community was an ATM. Thus it seems unlikely that ATMs would receive significant deposits from out of state consumers. One must even question the real value of ATMs' cash dispensing. Good substitutes, such as travelers checks, cash taken along on a trip and credit cards already exist.

Nevertheless consumers may adopt nationwide networks because they perceive great value in being able to access out-of-state ATMs, regardless of whether they use a nationwide network or not. The perceived value of nationwide ATM networks could conceivably expand into a perceived value of nationwide banking. This could generate consumer support for the efforts of many banks to have the prohibition on interstate banking repealed. When the prohibition does fall, banks that participate in shared ATM networks would probably have a competitive advantage, having already established a presence in many markets via shared ATMs.

Today the legal standing of nationwide networks remains unclear. The Comptroller of the Currency and the Federal Deposit Insurance Corporation do not consider ATMs to be branches. This interpretation follows the leading EFT decision in **Independent Bankers Association versus Smith,** which distinguishes off-premise ATMs from brick-and-mortar branches.[11] Even on an interstate basis, the Comptroller does not consider "common accessing" of terminals to be branching when there is no ownership of the terminal and a fee is paid for using another bank's ATM. However,

[10]MPACT is tied into Cirrus through the membership of Mercantile Texas Corporation—its parent organization, and Pulse is with RIA.

[11]Raymond Scqudlo, "Branch Banking Law and EFT Deployment," **Journal of Retail Banking**, May 1981, pp. 63-69.

**Viewed from this larger perspective, the emergence of nationwide ATM interchange signifies early jockeying for positions in the future electronic payments system.**

some state laws conflict with the Comptroller's interpretation. For example, Illinois has a contiguous state requirement for electronic transaction interchange, and Florida prohibits the use of electronic terminals by out-of-state banks.[12] In states where statutes or regulations disagree with the Comptroller's interpretation, national banks must comply with state laws. Nevertheless, banks in virtually every state, including Florida and Illinois, have announced plans to participate in one of the nationwide networks even though this participation may have to be limited until federal geographic restrictions or specific state statutes or regulations are changed.

Positioning for interstate banking is not the only impetus for developing nationwide shared ATM networks. Economic and competitive factors and the long-term payments system outlook also come into play. Dale Browning, president of Plus Systems, a nationwide shared system that will begin operations next year, cited five objectives for nationwide sharing of ATMs: "(1) Split the cost and risk of development of new products (2) Significantly lower the cost in the delivery of a product (3) Bring a national flavor to the services provided, and therefore enhance perceived value (4) Position regional banks as well as money-center banks to take immediate advantage of interstate banking liberalization (5) Overcome present geographic restrictions which do not apply to nonbanks."[13]

Perhaps it is significant that Browning's first objective implies the development of products beyond ATMs. Viewed from this larger perspective, the emergence of nationwide ATM interchange signifies early jockeying for positions in the future electronic payments system. It is easy to envision that the same switching systems now being developed for ATMs will be enhanced to facilitate interchange of transactions that originate from the point of sale. Ultimately ATM, point-of-sale and home-banking services must be integrated into a single network if the electronic payments system is to offer a true alternative to checks.

## Large Banks' Approach to Shared Nationwide ATM Networks

It may have been the bankcard associations' plans for nationwide ATM services that made banks aware of the need to work together to develop alternatives that more fully fit their needs. The original Visa plan required participating banks to share all ATMs in their networks and to place the Visa logo on all machines. As the plan was originally proposed, consumers would have been able to use standard Visa cards, which provide little space for bank identification, to operate bank-owned ATMs nationwide. The system that Master Card proposed comprised 400-500 association-owned Master Teller ATMs, accessible with Master Cards, to be placed in strategic locations nationwide.[14]

In the face of these initiatives by bankcard organizations, banks that had invested in developing proprietary ATM systems were concerned. The competitive benefits of proprietary ATM networks, the product differentiation that these banks had so carefully nurtured, could be lost. The possibility became clear that ATMs (and perhaps ultimately the electronic payments system) could become a utility that customers would identify with Visa and Master Card. Furthermore the bankcard associations' international presence could extend the utility concept to retail electronic payment services worldwide.

The competitive implications and preemptive possibilities inherent in the Visa and Master Card initiatives were too extensive to be ignored.

[12]Michael Weinstein, **EFT Report**, September 1, 1982, p. 2.
[13]Bill Streeter, Special Report: Bank Cards, "What's Real Significance of National ATM Networks?", **ABA Banking Journal**, September 1982, p. 43.
[14]Bill Streeter, Special Report: Bank Cards, "Visa and Master Card: Self-Evaluations," September 1982, p. 56.

Large financial institutions responded with two alternative plans, called Plus and Cirrus. These alternatives permit banks with proprietary ATM networks to retain their competitive benefits in local market areas and still provide customers the convenience of nationwide ATM access.

**Plus System Inc.** Plus enjoys a distinct capital advantage. The initial fee for proprietary membership in Plus was originally $100,000, and 31 financial institutions subscribed to Plus at that price. That gave Plus a considerable capital base.

Plus also has the advantage of a pre-existing operating switch. Rocky Mountain Bank Card Association has operated a shared regional ATM system, also named Plus, in Colorado, Utah, Nebraska, Kansas, Arizona, California, Idaho, Montana, New Mexico, Nevada and Iowa. It owns the switch that the nationwide Plus system will use when it goes on line next April.

In the Southeast, Plus has succeeded in attracting First Atlanta Corp., Southeast Bank in Florida, First Tennessee Bank, and Louisiana National Bank in Baton Rouge. These banks, like all Plus charter members, have exclusive rights to the Plus name in respective territories that may encompass an entire state. They have the right to sponsor non-equity participants in their territories if they choose. Equity members also have voting rights over the future destiny of the Plus system. These features give equity members a considerable degree of control, at least in their own territories.

**Cirrus System, Inc.** Cirrus, the second large national ATM network, began about the same time as Plus. It is based on the same general concept but features a lower entry cost. Cirrus members' voting privileges and exclusive market territory rights are similar to Plus, and equity members have the power to approve any sponsored members. Cirrus equity members pay an initial $25,000 fee for membership. While this price may be a marketing advantage, it also left Cirrus cranking up operations with a substantially smaller capital base than Plus.

Cirrus members in the Sixth District are Trust Company of Georgia and Sun Banks of Florida. Trust Company has already begun to market Cirrus to downstream banks. In October it announced a statewide shared network that will be open to banks, savings and loan associations and credit unions. Participants, who do not need their own ATMs to join the Georgia network, will become corresponding members of Cirrus.

## The Regional Shared ATM Networks' Approach

The nationwide ATM network that reflects the position of the generally smaller banks presently sharing local and regional networks is Regional Interchange Association (RIA). An outgrowth of the Regional Interchange Working Group, which began meeting in June 1981, RIA has signed up 13 large regional shared networks. In all, its members operate terminals in more than 27 states.[15]

The RIA philosophy clearly differs from that of Cirrus and Plus. Cirrus and Plus are dominated by large commercial banks with exclusive territories and rights to determine which other banks in their territories, if any, can offer customers the benefits of these two nationwide systems. RIA's objective is to unite regional and local shared systems in a national alternative to Visa and Master Card. However, RIA participants have no exclusive market rights. From the RIA perspective, ATM interchange may become a utility, but it should be a utility in which smaller financial institutions have a substantial voice. A statement from the Regional Interchange Working Group's original proposal reflects its dedication to allowing smaller banks to share in the system's control. The statement referred to the Visa and Master Card proposals, and it noted that "when measured by credit card outstandings, some 125 banks held 80 percent of the total credit issued."[16] This suggests that smaller banks may feel they have an inferior position in the bankcard associations.

Even though the shared control philosophy is not common to Sixth District financial institutions, First Financial Management Corporation and one Sixth District bank holding company, Flagship Banks in Florida, have joined RIA. Since no out-of-state bank's customers can access ATMs in Florida at present, Flagship may view its membership in RIA as participatory research. It is not clear, then, whether the cooperative utility philosophy regarding nationwide ATM networks has actually found a foothold in Florida.

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[15]Telephone conversation with James Martin, Chairman and President, RIA, November 1982.

[16]Jeffrey Kutler, "They Seek Alternatives to Card Networks," **Transition**, October 1981, p. 26.

## A Glimpse of the Future From Florida?

Perhaps Publix Supermarkets, Inc.'s determination to establish its own network of ATMs in its 260 Florida retail locations has prompted Flagship Banks' participation in RIA. The Publix efforts did prompt formation of a seven-bank study group to explore a statewide shared ATM network controlled by banks. In addition to Flagship, participants in the study include Atlantic Bancorporation, Barnett Banks of Florida, Inc. Exchange Bancorporation, First Florida Banks, Inc., Florida National Banks of Florida, Inc. and Southeast Bank, NA. These are seven of the eight largest bank holding companies in the state.[17]

It is not surprising that these banks perceive the Publix ATM initiative as a significant threat. The retailer claims 25 percent of the grocery market in Florida. Its stores are located primarily in upscale neighborhoods. And all stores are equipped with electronic scanners that read the Universal Product Code (UPC) and record purchases automatically. (UPC is the bar code printed on most items found in grocery stores.) If Publix succeeds in signing up a substantial number of financial institutions, including some of the largest banks, as participants in its ATM system, the arrangement could easily evolve into a retailer-controlled point-of-sale network. Florida banks are concerned that Publix' next step could be to become a retail bank, accepting deposits from many of the 15,000-20,000 customers who visit each of the chain's supermarkets every week.[18]

Financial institutions throughout the nation also face competition from retailers like Sears and Kroger, who are aggressively entering the financial services field. Both banks and retailers can benefit from the economies of electronic payment transactions. However, from a marketing perspective the two industries seem far apart. Retailers want all banks to participate in a single point-of-sale service accessible to the stores' customers regardless of where they bank. Many bankers, on the other hand, prefer

**A major Florida retailer has seized the initiative, establishing its own ATM network and selling participation in it to banks.**

to operate proprietary systems to attract customers to their banks. Thus far, banks and retailers have found no effective compromise on this point, although some retailers have conceded that a **limited** number of competing systems could be advantageous to them. Limited competition could enable retailers to negotiate favorable terms for their participation and still provide the broad bank coverage they need to serve their customers.

Florida may be a bellwether state. A major Florida retailer has seized the initiative, establishing its own ATM network and selling participation in it to banks. The success or failure of that effort holds important implications for the financial services industry nationwide. Will Publix' initiative be emulated in other areas? It is almost certain that it will. For example, Southland Corp. has announced plans to install ATMs in some or all of its 7,000 Seven-Eleven stores.[19] Will major banks, the leaders in their markets, join these retailer-operated systems? It is possible. Sun Banks of Florida, the state's third largest bank holding company, joined the Publix ATM network in October. Will large commercial banks, without the impetus of regulation, forego their preference for proprietary ATM services and form shared networks accessible to customers of major competitors in the same marketplace? The answer to this question is least clear. The work of the seven-bank study group in Florida may offer a clue. The group's existence itself is noteworthy, for

[17] Bradley Schade, "Florida's Sudden Push for Shared Nets," **Bank Network News** August 23, 1982, pp. 1-3.
[18] *Ibid.*

[19] **Washington Post**, July 13, 1982, p. 6.

there is no precedent for cooperative efforts on the part of banks in that state. But the incentive is great. Control of an emerging payments system may be at stake.

## Conclusion

The race to establish nationwide networks is a battle for control. Some major banks recently have concluded that control of the payments system is an important competitive advantage for the industry—one that has suffered, perhaps, from neglect.[20] These banks believe fees for payment transaction processing will prove an increasingly important source of revenue in the new age of deregulated banking. They seem determined to keep that revenue in the banking industry by maintaining control of the emerging electronic payments system. They view such nonbank entities as Sears, Merrill Lynch, American Express and even the bank credit card organizations as competitors for that control. The threat of outside competition is inducing banks to cooperate and share. Yet banks face a dilemma. The colleagues they seek to cooperate with are competitors as well.

Perhaps the real importance of the ATM sharing phenomenon, then, is that it represents banks' struggle to find a comfortable balance between competition and cooperation in the payments system. In the emerging electronic payments system, banks are seeking opportunities to gain a competitive edge vis-a-vis other banks. However, it appears that the needs of payments system users are not always well met by banks' competitive stance. Users need a system that facilitates payments regardless of where they bank. It remains to be seen whether financial institutions will succeed in developing cooperative organizational structures for a system that protects and enhances their competitive positions. If they are not successful in the near future, others, such as retailers or the bankcard organizations, may preempt the industry's control by designing systems that meet their own and their customers' needs and selling banks access to those systems. The ATM sharing competition is only the tip of the iceberg for the emerging electronic payments system in the nation and in the Southeast.

**—Veronica M. Bennett and Don Sabbarese**

*Don Sabbarese is an instructor of economics at Kennesaw College—currently conducting dissertation research at the Federal Reserve Bank of Atlanta.*

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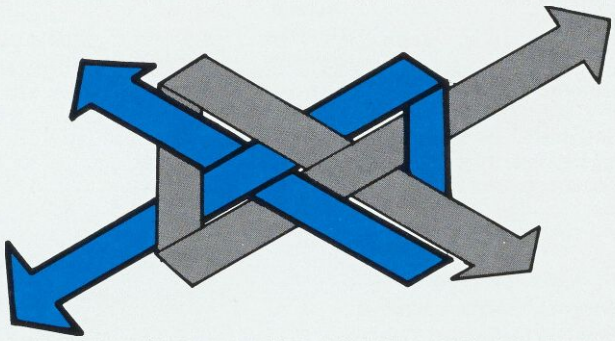
[20]Arthur D. Little, Inc., **Issues and Needs in The Nation's Payment System: A Perspective for Banking's Policy Makers**, Association of Reserve Bankers, (Washington, D.C. 1982), p. 2.

# Consolidation of the Regulatory Agency Structure:



# Has the Time for It Come?

**America's bank regulatory system, the subject of a new Reagan administration review, has persisted because it afforded a reasonable way of dealing with the complex objectives of financial regulation. With deregulatory pressures mounting, the industry will face more discussion of proposals for regulatory change.**

The structure for regulating U.S. financial institutions is extremely complicated. This regulation is the full-time activity of the Comptroller of the Currency, the Federal Home Loan Bank Board, the National Credit Union Administration, and the Federal Deposit Insurance Corporation, and represents a major responsibility of the Federal Reserve System. Other federal agencies, such as the Securities and Exchange Commission and the Justice Department's Antitrust Division, have significant regulatory responsibilites relating to financial institutions. In addition, each of the 50 states has at least one agency responsible for supervising financial institutions.

These responsibilities frequently overlap and may, at times, conflict, although in recent years attempts to resolve such conflicts have been formalized through interagency coordinating committees. But the newly created Depository Institutions Deregulation Committee (DIDC) and the Federal Financial Institutions Examination Council, with their own staff and responsibilites, represent an additional layer of regulation.

It has become traditional to describe the complex U.S. financial regulatory structure as a result of historical accident rather than of reasoned policy judgments. But this characterization may be unfair. While reformers have long called for some simplification or consolidation of the regulatory agencies (see Exhibit 1), the agency structure reflects the complicated system of law and regulation relating to financial institutions, and the sometimes conflicting objectives of these regulations.

Each time the Congress has enacted legislation relating to financial institution regulation, it has considered how the law should be administered and has debated the merits of divided responsibility versus centralization. One can disagree

**Exhibit 1**

Summary Of Restructuring Proposals

Centralize All or Some Federal Bank Supervision or Policymaking in One of the Following Agencies

| | Federal Reserve System | Federal Deposit Insurance Corporation | Treasury | Bank Commission | New Agencies |
|---|---|---|---|---|---|
| 1. 1919-21—Legislative proposals, 66th and 67th Congresses | X | | | | |
| 2. 1937—Brownlow Committee report | | | X | | |
| 3. 1937—Brookings Institution report | | X | | | |
| 4. 1938—Legislative proposal, 75th Congress | | | X | | |
| 5. 1939—Legislative proposals, 76th Congress | | X | | | |
| 6. 1949—Hoover Commission report | | | X | | |
| 7. 1961—Commission on Money and Credit report | X | | | | |
| 8. 1962—OCC Advisory Committee on Banking report | | | X | | |
| 9. 1962—FDIC Chairman Cocke's plan | | X | | | |
| 10. 1963—Legislative proposal, 88th Congress | | | | X | |
| 11. 1965—Legislative proposal, 89th Congress | | | X | | |
| 12. 1965—Legislative proposal, 89th Congress | | | | X | |
| 13. 1965—Independent Bankers Association of America plan | | X | | | |
| 14. 1969—Legislative proposal, 91st Congress | | | | X | |
| 15. 1971—Hunt Commission report | | | | | X |
| 16. 1974—FRS Governor Sheehan's plan | X | | | | |
| 17. 1975—FDIC Chairman Wille's plan | | | | | X |
| 18. 1975—Financial Institutions and Nation's Economy recommendation | | | | X | |

Source: **The Debate on the Structure of Federal Regulation of Banks**, U.S Government Accounting Office, April 14, 1977.

with the decision, for example, to make the Federal Reserve the principal regulatory agency for bank holding companies, or with the creation of the DIDC to oversee the phaseout of interest rate ceilings, or with the division of responsibilities for the Truth-in-Lending Act, but it would be misleading to view those decisions as "accidents."

## Objectives of Financial Regulation

The U.S. arrived at its complicated regulatory system because financial regulation has been responsive to several traditional themes in American history. One such theme was distrust of concentrations of financial power. This may be viewed as a holdover from the populism of decades ago, but many Americans remain reluctant to see financial decisions made in one place—be it Wall Street, Constitution Avenue, or Pennsylvania Avenue. This concern is illustrated in the laws regarding branch banking. Many states prohibit or restrict branching to prevent big city banks from dominating their banking.

Concern over concentrated financial power relates not only to financial institutions but also to the regulation of financial markets. Many observers believe that divided responsibility for financial regulation produces greater opportunities for innovation.

Related to this theme is the emphasis on competition in the financial system. There are 15,000 commercial banks in the United States,

Summary of Selected Proposals to Restructure Federal Bank Supervision

**1949. Hoover Commission Report**

The Hoover Commission recommended that FDIC be transferred to the Treasury Department. The Commission also recommended creating a National Monetary and Credit Council to coordinate bank supervision by the Treasury Department.

**1961. Commission on Money and Credit Report**

The Commission on Money and Credit, established by the Committee for Economic Development, a private study group, recommended that the supervisory functions of OCC and FDIC be transferred to FRS.

**1962. OCC Advisory Committee on Banking Report**

The Comptroller of the Currency's Advisory Committee on Banking recommended that the sole federal regulatory authority over insured state banks be vested in FDIC, which would be reorganized under a single administrator and transferred to the Treasury Department. Authority to approve branches of state banks would be vested in state authorities. The Committee's report did not discuss how FRS would obtain bank examination information which might be needed to discharge its monetary function.

**1971. Hunt Commission Report**

The Presidential Commission on Financial Structure and Regulation (Hunt Commission) recommended establishing:

- an "Administrator of National Banks" incorporating OCC's supervisory responsibilities,
- an "Administrator of the State Banks" incorporating FRS's and FDIC's supervisory responsibilities, and
- a "Federal Deposit Guarantee Administration" incorporating FDIC's insurance responsibilities.

Unlike various proposals to vest supervisory authority in a multi-member commission, the Hunt Commission was attracted to the single administrator idea.

**1975. FDIC Chairman Wille's Plan**

The Chairman of FDIC, Frank Wille, suggested that the examination and supervisory functions of FDIC and FRS be merged into a new agency under a single administrator. He also proposed a five-member Federal Banking Board with power to implement a "uniform national policy" for bank regulation.

**1975. FINE Study Report**

A study conducted by a subcommittee of the House Committee on Banking, Currency and Housing, entitled "Financial Institutions and the Nation's Economy" (FINE), recommended establishing a "Federal Depository Institutions Commission" which would have combined the supervisory and examination functions of FDIC, FRS, OCC, the Federal Home Loan Bank Board, and the National Credit Union Administration.

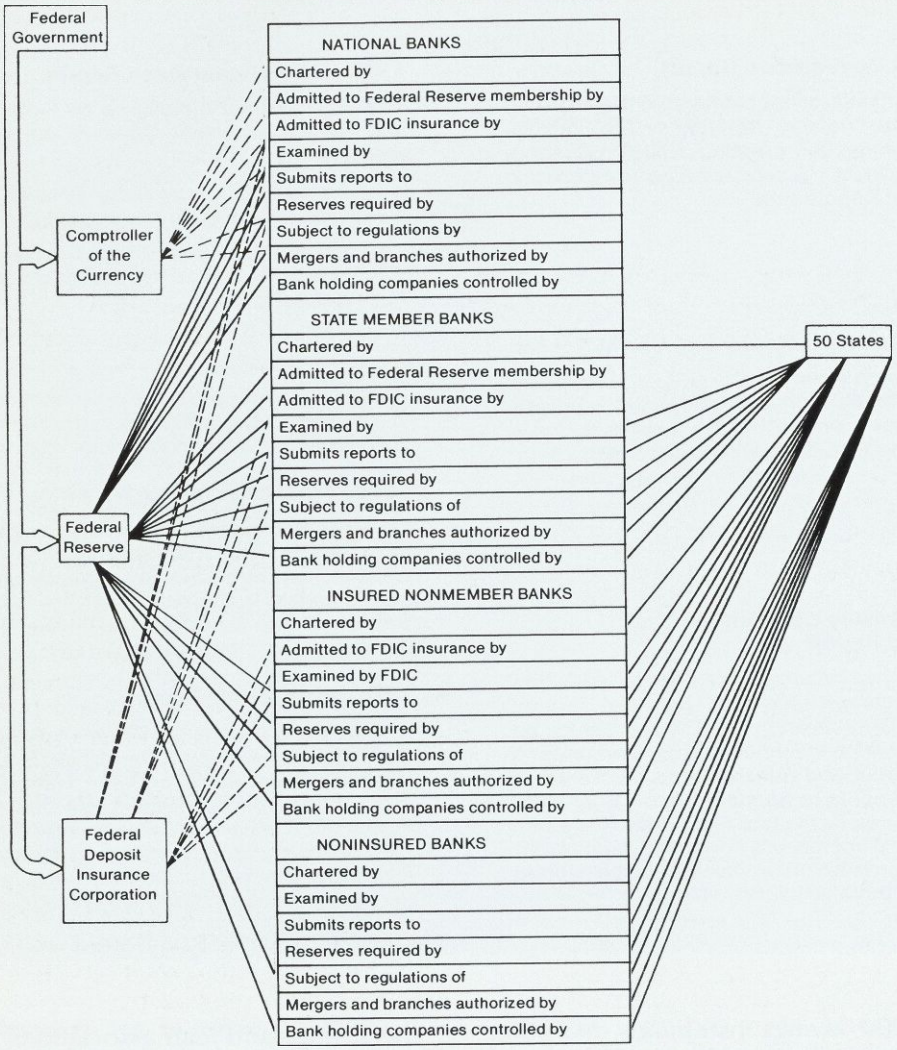
as well as 4,000 savings institutions. No other country has a similar banking structure, and Americans would reject a system that results in just a few banks, as in Canada or England. Clearly, the task of regulation is more difficult and the regulatory agency structure harder to design than in a system that eliminates competition.

Americans also believe that certain economic sectors should be assured access to credit possibly unavailable in a financial system dominated by a few giant institutions. Housing, agriculture, small business and local government usually are viewed as deserving special protection. Concern with credit for housing has spawned a whole system of financial institutions, the savings and loan associations, to meet this need. And the Federal Home Loan Bank System is responsible not only for supervising and regulating S&Ls in the traditional sense but also with "promoting" the industry.

All these themes may at times conflict with the dominant theme that runs through the history of U.S. financial regulation— preserving the safety and soundness of financial institutions. Most restrictions on commercial bank operations grew out of concern with assuring bank safety and soundness, and with preventing failure.

Our complex regulatory structure was developed to deal with these often conflicting objectives.

**Chart 1. The Tangled Web of Bank Regulation**




Source: Adapted from Hearings on Financial Structure and Regulation, Subcommittee on Financial Institutions of the Senate Committee on Banking, Housing and Urban Affairs, 93rd Congress, 1st session, 1973. Cited in Murray E. Polakoff, Thomas A. Durkin, et. al., **Financial Institutions and Markets**, 2nd ed., (Boston: Hughton-Mifflin) 1981.

## The U.S. Regulatory System

A distinctive feature of the complex U.S. banking system is that bank charters are available from either the federal government or from the states. The federal role is easily explained by the interstate nature of much banking business and by the Constitution's delegation of responsibility for the money supply to Congress. The state role is based on American skepticism toward central decision making. If all bank charters were issued by an official in Washngton, how could local businessmen and households be confident that Washington would understand fully the needs of their scattered communities?

Advocates of the dual banking system have long argued that its preservation requires that regulation at the federal level be carried out by different officials for state and national banks. They fear that if federal supervision of state-chartered banks rested with the same official who charters national banks, he might favor banks he chartered over those chartered by the states. (Interestingly, while a dual chartering system also exists for savings and loan associations, there is only one supervisory agency at the federal level.)

The federal bank regulatory structure was complicated further by the voluntary nature of membership in the Federal Reserve System, whereby state-chartered banks could choose whether or not to be members. Most have opted not to be members. When federal deposit insurance was introduced, it also was optional for state-chartered banks though quite attractive. The original plan required all federally insured banks to become members of the Federal Reserve, but that provision was dropped before it became effective. Thus, federal supervision of state-chartered banks is now divided between the Federal Reserve System and the Federal Deposit Insurance Corporation (FDIC).

The regulatory structure becomes more complicated when we consider nonbank depository institutions. There are dual chartering and supervisory systems for S&Ls, credit unions, and mutual savings banks. Separate deposit insurance systems have been established for credit unions and savings and loans (mutual savings banks are insured by the FDIC or the Federal Savings and Loan Insurance Corporation (FSLIC) depending on the savings bank's charter). With the exception of FDIC supervision of state-chartered mutual savings banks, the supervision of thrift institutions is completely separate from that of commercial banks.

## Problems with the Present System

Reformers emphasize three concerns about the existing structure of regulation. First, the multiplicity of agencies with similar responsibilities may be unnecessarily costly or inefficient. Second, gaps in the regulatory structure may cause safety and soundness problems to be overlooked. Third, overlapping responsibilities may lead to conflicting rulings that are difficult to resolve or that treat similar institutions differently.

Some savings might result from consolidating the research, legal, data processing and training functions of the several regulatory agencies. If one agency were responsible for examining all banks or all depository institutions, it might reduce travel time and costs. However, in 1979 congressional testimony, the FDIC estimated that the savings from consolidating the agencies would be less than $1 million a year.

**The dominant theme that runs through the history of U.S. financial regulation is preserving the safety and soundness of financial institutions.**

The possibility of regulatory gaps is important because the potential social losses are much greater than the cost of duplication or overlap. A gap might let some problem go undetected, for instance, if each agency believed the problem fell in somone else's bailiwick. Transactions between a bank and its parent holding company may escape appropriate scrutiny when each is supervised by a different agency. While such problems have arisen in a few cases, procedures have been developed to deal with such situations.[1]

More significantly, overlapping responsibilities could permit the same regulation or law to be applied unevenly to different institutions. While differences in interpretations are inevitable, the real concern is that such differences may not be random but systematic—a "competition in laxity" as one agency or another seeks to help its "constituency" by adopting a permissive regulatory posture. Former Federal Reserve Chairman Arthur Burns has charged that "the present system is conducive to subtle competition among regulatory authorities, sometimes to relax constraints, sometimes to delay constructive measures."[2]

Our multiple-agency regulatory system also results in duplicative administrative processes. A

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[1]See Bernard Shull, "Federal and State Supervision of Bank Holding Companies," in **State and Federal Regulation of Commercial Banks,** Vol. 2, FDIC, 1980.

[2]While no study has been able to document a record of actions taken by any agency motivated by concern for regulated institutions and inimical to the

state-chartered bank's application for a branch, for example, must be approved by both state and federal agencies. The delays from this process are costly to the banks involved, though both the Federal Reserve and the FDIC have taken steps to reduce the time and costs of application approvals.

Former FDIC Chairman Frank Wille summarized the arguments for and against consolidation in testimony before the House Banking Committee in 1975 (Exhibit 2).

While financial industry observers agree the present system isn't the one they would design if they were starting with a clean slate, they offer at least three distinct views as to the appropriate course of action:

1. Some argue that the present system's disadvantages are substantial. Therefore, we need some consolidation to eliminate conflicts and inequities, or to achieve operating economies. Those in this camp do not necessarily agree on a solution to the problems.
2. A large group argues that while the present system appears to be unnecessarily complicated, it nevertheless works reasonable well. They argue that cost savings from consolidation would be small, and that the infrequent conflicts among agencies can be resolved by consultation. They note the substantial costs in managing the transition to a new system, and the large political costs in obtaining agreement on any particular change.
3. A smaller group believes the present system, despite its complexity has substantial advantages that would be lost in a change to a system with a neater organization chart. They believe that possibilities for experimentation in a system of divided supervisory responsibility outweigh any extra costs involved.

Despite many proposals for reform, the present system has persisted, not by accident, but because of a predominant view that it represents a reasonable means of dealing with the multiple and conflicting objectives of financial regulation. Yet, however reasonable the decision was not to consolidate in 1975 (or in 1982), changes in the financial system have loosed forces that will make consolidation more likely in the future than in the past.

This article will focus on the changes taking place in the financial services market that appear to make regulatory consolidation more likely. These include the uniform reserve requirements of the Monetary Control Act of 1980, the acquisition of commercial bank powers by thrift institutions, declining barriers to interstate banking, and the pressures for commercial banks to expand into nonbanking activities to compete with nondepository providers of financial services.

**Exhibit 2**

Arguments For And Against Agency Consolidation

**For**

1. Simplification of Administration
2. Elimination of Monetary Policy as a Conflicting Goal
3. Economy and Efficiency of Operation
4. Elimination of Actual or Potential Policy Conflicts
5. Facilitating the Handling of Failing Banks
6. Improved Regulation of Bank Holding Companies, their Affiliates, and Certain Other Bank Relationships.
7. Gains to Banks and Bank Customers from a Single Federal Agency
8. Adjusting to a Rapidly Changing Environment

**Against**

1. The Present System Has Worked Reasonably Well
2. A Single Agency Will Not Assure Uniform Performance in All Supervisory Activities
3. Concentration of Power and the Elimination of Regulatory Choice
4. Benefits of Diversity

Source: Frank Wille, Testimony before the Committee on Banking, Housing and Urban Affairs, U.S. Senate, December 8, 1975.

## Implications for Unified Regulation of Banks and Thrifts

A separate supervisory agency for S&Ls at the federal level was appropriate when S&Ls were

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public interest, there are instances in which conflicting decisions have been made by the various agencies. An interesting recent example was the promulgation of regulations by the Federal Reserve and the Federal Home Loan Bank Board limiting holders of NOW accounts. The Federal Reserve adopted a more restrictive regulation which would have limited the ability of thrifts to compete for some accounts held by commercial banks and which would have limited the conversion of some demand deposits into interest-paying accounts. Both agencies had reasons for their actions based on broad public policy considerations and neither action could be considered "laxity." Nevertheless, the conflicting decisions did lead to delay, confusion, and legal costs.

**Table 1.** Changes In Insured Commercial Banks
1975 - 1981

| Year | Net Change in Number of Banks (percent of total) | | | New Banks (percent of total) | | |
|---|---|---|---|---|---|---|
| | National | State Member | Non Member | National | State Member | Non Member |
| 1975-1979 | −185.3 | −69.9 | 361.1 | 28.2 | 9.7 | 62.1 |
| 1980-1981 | 13.7 | 84.3 | 2.0 | 39.9 | 13.1 | 47.0 |

primarily an instrument for increasing the availability of housing. But as S&Ls obtain more commercial bank powers, there is less reason to continue a separate supervisory arrangement, let alone to perpetuate a regulatory agency charged with "promoting" the industry.

In addition to regulatory differences, there are now separate federal deposit insurance funds for commercial banks, savings and loans, and credit unions. Consolidating these insurance funds seems appropriate, even if credit unions continue as specialized institutions. The rules should be identical with respect to protecting the depositor, and consolidation would facilitate this step. Further, at the present time the FDIC is financially better able to meet potential calls upon it than the FSLIC, so consolidation would strengthen the deposit insurance system. Commercial banks may object to "their" deposit insurance fund being used to support competitors, but the insurance funds' public purpose would be served by such consolidation. In fact, combining the insurance funds may be warranted even without any agency consolidation.

## Implications for the Dual Banking System

Several developments likely will diminish the states' role in bank supervision and in determining banking structure. The Monetary Control Act has already moved us in that direction. Its requirement that all depository institutions, regardless of charter, maintain reserves with the Federal Reserve, removes a major incentive for holding a state charter—the opportunity to operate at typically lower state reserve requirements. While the impact of charter conversions will be slow, the trend will be toward national rather than state bank charters. At a minimum, the uniform reserve requirements of the Monetary Control Act will remove the incentive for national banks to convert to state nonmember bank status. We can already see how that trend has developed since that act became effective (see Table 1).

**The present system has persisted, not by accident, but because of a predominant view that it represents a reasonable means of dealing with the conflicting objectives of financial regulation.**

The states will have to cope with interstate banking. A state-chartered bank will be subject to supervision and regulation by each state in which it operates branches. It will be able to avoid the inconvenience and expense of this multiple supervision by choosing a national charter, so all its operations will be supervised by the Comptroller of the Currency. An alternative supervisory structure, whereby each state would examine the interstate operations of banks it chartered, does not appear feasible; few states have the

resources or the will to examine those operations. Inevitably, banks that operate branches in more than one state will do so with a national charter. Interstate bank holding company operations involving separately chartered banks would be free from some of these disadvantages but would still have a state regulator in each state where they operated.

Some advantages of state bank charters will remain attractive (more liberal lending limits in some states may be the most important). But the advantages of a national charter will be most important to the larger banks, and the state banking departments are likely to face further conversions to national charters.

## Implications for Federal Agency Structure

Despite concern that the present divided structure of commercial bank supervision leads to a "competition in laxity," it is difficult for institutions to move from one supervisor to another. A bank may prefer to be supervised by a different agency, but any change involves a number of problems. In the past, state-chartered banks may have preferred to deal with a single supervisor rather than a combination of state and federal supervisors, but remained with the state charter to avoid Federal Reserve reserve requirements. Some chose to operate as state member banks because of the state charter's advantages and because Federal Reserve membership offered them access to Fed services and an enhanced ability to compete for correspondent business that outweighed the cost of reserve requirements. But these issues—reserve requirements and access to Fed services—are no longer relevant.

As the concept of Federal Reserve membership loses importance, the division of federal responsibility for fewer state-chartered banks will come increasingly into question. Reformers will be asking why both the Federal Reserve and the FDIC supervise banks subject to identical operating regulations.

It is possible to rationalize a continued supervisory role for both the FDIC and the Federal Reserve. One approach would be to turn over all responsibility for supervision of state-chartered banks to the Federal Reserve, while the FDIC would administer federal deposit insurance for all banks—national and state. Examination and supervisory responsibility obviously is not essential to the deposit insurance function, since the FDIC now insures—but does not examine—national banks.

An alternative favored by some would be to turn over total responsibility for federal supervision of state-chartered banks to the FDIC, removing the Federal Reserve from any bank supervisory role. Since the Federal Reserve now supervises relatively few commercial banks (perhaps too small a number to achieve minimum operating and travel costs), advocates say this might offer the least disruptive solution. But the Federal Reserve has important monetary policy responsibilities it will retain regardless of any changes in the structure of banking supervision. Whether the Federal Reserve should give up its supervisory responsibilities depends crucially on whether its ability to conduct monetary policy is enhanced by its supervisory activities. This is a subject much debated over the years, with no clear-cut resolution (see Box). In any case, the Monetary Control Act removed important premises of the rationale for a system in which the FDIC and the Federal Reserve provide alternative supervisory services for banks subject to identical regulations. As a result, pressures for consolidation or reorganization of responsibilities are likely to mount.

## Implications for Merger and Holding Company Authority

The Comptroller generally is viewed as being more permissive toward mergers than the other agencies.[3] In a few cases, banks have converted from a state charter to a national charter in search of a more permissive regulator. In other cases consolidations have been structured as mergers, rather than as holding company acquisitions, in order to have the application reviewed by the Comptroller rather than by the Federal Reserve. But up to now such cases have been rare, and a degree of uniformity has been imposed by the Justice Department's role in reviewing every bank acquisition.

This minor problem will become much more significant in the future. Deregulation and interstate banking will greatly increase the number of mergers and holding company acquisitions, some of greater size than have occurred in the past. It

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[3]See Robert Eisenbeis, "Differences in Federal Regulatory Agencies' Bank Merger Policies," **Journal of Money, Credit and Banking**, 1975.

**Box**

**SHOULD THE FEDERAL RESERVE HAVE A ROLE IN BANKING SUPERVISION?**

The Federal Reserve now has both monetary policy responsibilities and some responsibility for supervision of banks and bank holding companies. Observers have long debated whether that combination of duties represents an advantage or leads to unnecessary conflict.

At one time advocates claimed that combining monetary policy with bank supervision was beneficial because pressure can be transmitted to banks through the examination process to adopt liberal or tight lending policies in accord with current objectives of monetary policy. That argument has disappeared; virtually no one argues for the use of bank supervision as a tool of macroeconomy policy.

Nevertheless, the Federal Reserve has long believed that the information obtained in the course of bank examination and supervision is useful in making monetary policy decisions. Governor J. Charles Partee has testified that "the Board is convinced that bank supervision and monetary policy are closely and inevitably linked, and that supervisory policy and monetary policy should not be determined in isolation.... In the Board's judgement, breaking this link could at times impair the Federal Reserve's ability to carry out monetary policy effectively."* On the other hand, a 1977 study by Professor Manfred Peterson concluded that "there is no evidence that data from bank examinations have been used in the formulation of open market policy. The meager evidence suggests that examination data are not very useful for monetary policy."**

Some see potential conflict between supervisory and monetary policy responsibilities. Because of the importance of monetary policy, supervisory issues may get less attention from Federal Reserve Board members (or, put the other way, the demands of supervisory matters and applications on Board members' time may detract from monetary policy formulation). Further, some critics of the Federal Reserve's combined role believe that the necessarily controversial matters of monetary policy lead the Federal Reserve to avoid controversy in the supervisory arena. Such an approach, they contend, may not lead to optimum policy-making on supervisory matters.

*Hearings before the Committee on Banking, Housing and Urban Affairs, U.S. Senate, February 28, 1979.
**Conflicts Between Monetary Policy and Bank Supervision, **Issues in Bank Regulation**, Autumn 1977.

would be intolerable to have differing policies in effect at the different agencies. Such differences would create substantial inequities and lead banks to seek the most permissive regulator.

This problem could be resolved by giving a single agency the authority to pass on applications for mergers and holding company acquisitions. Alternatively, the acquisition process could be changed to eliminate the requirement for agency approval. Competitive implications of bank mergers would then be treated under the antitrust laws like mergers in all other industries. Recent court decisions that limited the agencies' ability to deny merger applications when the competitive effects do not constitute antitrust violations have weakened the logic of requiring agency approval. In any case, the current division of responsibility for bank mergers can scarcely continue when interstate banking generates applications for many large combinations that will pose new problems for decision makers.

Similarly, the current divided responsibilities for bank and S&L holding companies could create substantial inequities when S&Ls are competing across the board with commercial banks. At present, bank holding companies are supervised by the Federal Reserve, S&L holding companies by the Federal Home Loan Bank Board. Bank holding companies are allowed to engage in a rather narrow range of financial activities; such a holding company can do little that a national bank cannot do. S&L holding companies that own more than one savings association also are quite restricted. A holding company owning only one S&L, however, is unrestricted as to its other activities. The FSLIC Corporation has urged nonfinancial corporations to acquire ailing S&Ls to help solve the thrift industry's current problems. National Steel Corporation was the principal in one of the largest thrift mergers of 1981.

In general, a bank holding company cannot acquire an S&L, though the Garn-St. Germain Act allows such acquisitions to save a failing institution. When a bank holding company acquires a savings and loan, it becomes an S&L holding company as well, subject to regulation by the Federal Home Loan Bank Board as well as the Federal Reserve.

The lack of restrictions on nonfinancial activities of one-association S&L holding companies, compared with the severe restrictions on bank holding companies, poses no critical problem as long as commercial banking is distinct from the S&L business. But as savings institutions become indistinguishable from commercial banks, this difference will create both serious inequities and administrative problems. Moreover, the distinction between one-association and multiple-association S&L holding companies will tend to disappear with interstate branching. Then, an S&L holding company with subsidiaries in several states will be able to merge them to become a one-association holding company, with no restrictions on its nonfinancial activities. It may become attractive, in fact, for some commercial banks to convert to S&Ls to gain greater flexibility.

**The trend toward deregulation . . . will create substantial inequities among institutions and strains on the regulatory structure unless changes are made.**

This problem goes to the substance of the regulation of commercial banks and thrifts; it is not simply a matter of agency structure. However this difference is rectified (and it is not easy to see how), today's regulatory structure is not optimal now, and will be even less so in the future. As bank holding companies gain additional powers, the potential for transactions between the bank and its affiliates increases, and the divided responsibility becomes less efficient.[4] We have already noted that the division of responsibility for the bank and the holding company poses the only significant potential gap in the current supervisory system. Closing the gap involves an increasing cost in duplication and overlap. Those who favor separating the Federal Reserve's monetary policy functions from financial supervision obviously would favor substituting some other agency for the Federal Reserve in bank holding supervision. Yet the problem would remain if, for example, the FDIC were responsible for all bank holding company supervision. A feasible alternative would be to divide responsibility among the three banking agencies on the basis of the lead bank's affiliation in the holding company (Congress considered this at the time of the 1970 Bank Holding Company Act Amendments). The problem disappears with consolidation of the agencies, and that appears more and more likely as the role of the holding company expands.

[4]If interstate branching is authorized and banks are allowed all the activities of holding companies, then this problem may disappear as operations are carried out directly by banks rather than through the holding company vehicle.

## Conclusion

The complex and peculiarly American structure of financial regulation was designed to serve a variety of objectives and has functioned rather well over the years. However, the financial system it was designed to supervise is changing rapidly, and further change in the future appears inevitable. While there have been conflicts among the agencies, formal and informal avenues of coordination have been able to resolve most conflicts. The system is in no danger of breaking down or even of lapsing into a "competition in laxity." But the structure is in danger of becoming less and less appropriate for the realities of the financial system. The trend toward deregulation, which ultimately will include interstate banking and still broader powers for thrift institutions and bank holding companies, will create substantial inequities among institutions and strains on the regulatory structure unless changes are made. This will be particularly true for the division of responsibilities between federal and state authorities. While it has not been the purpose of this article to suggest any particular solution, it is clear that the direction of change must be toward consolidation of the agencies.

**—Paul M. Horvitz**

# Southeastern Employment: After the Recession

**Jobs in services, trade and finance have shown the most stability in the region over the last 18 months. An Atlanta Fed survey suggests that hiring in the immediate future will be fairly slow, although services and finance will remain sources of strong long-term job growth.**

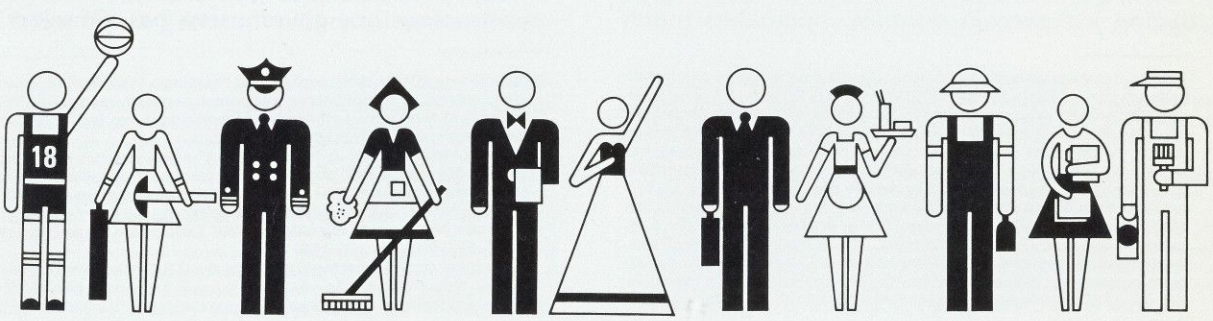
After several decades of generally increasing prosperity and rapid economic growth, the Southeast has finally experienced the shadow of recession. In particular, rising unemployment rates in several states of the Sixth Federal Reserve District have raised questions about future trends in the region's employment patterns (see Note). Which job sectors have best withstood the recession? When is recovery likely in badly affected industries? Which sectors offer the greatest potential for short- and long-term job growth?

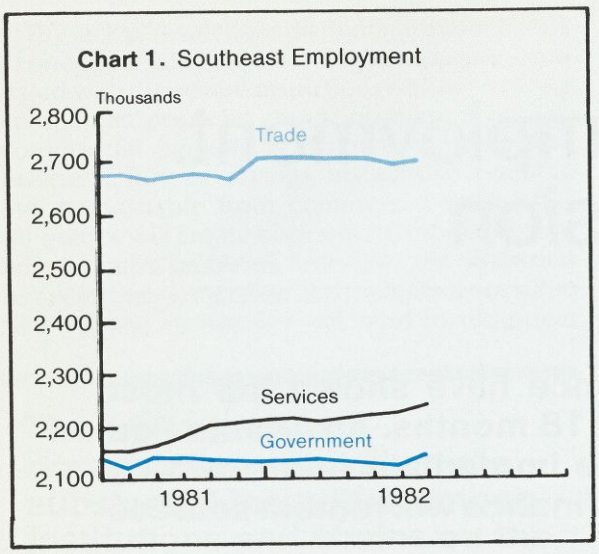
Note: Unless otherwise specified, the "Southeast" in this article refers to the six states all or partly within the Sixth Federal Reserve District: Alabama, Florida, Georgia, Louisiana, Mississippi and Tennessee.

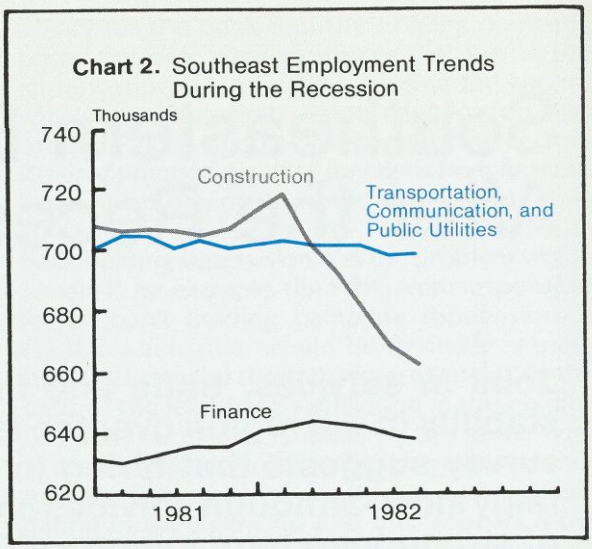
We used three approaches to answer these questions. First, we analyzed employment statistics from major job sectors during the current recession and compared them with historical trends since 1969. Second, we estimated short-term prospects for hiring and recovery by surveying industry representatives. Finally, we reviewed scholarly literature and state and national econometric forecasts to derive a long-term employment outlook.

## Employment Trends During the Recession

Despite a deep and broad recession that began in July 1981, some sectors of the southeastern economy have enjoyed job growth or






stability.[1] Services, trade, finance and printing and publishing, together had nearly 125,000 more jobs in the Southeast in July 1982 than a year earlier. Most of this expansion occurred in three nonmanufacturing sectors—services, trade, and finance (see Charts 1 and 2). In the Southeast, as across the nation, service and trade jobs grew throughout most of the recession, although at diminishing rates (see Chart 3). The creation of 400 positions at a new hotel near the Atlanta airport and 3,500 jobs at Walt Disney World's EPCOT (Experimental Prototype Community of Tomorrow) typifies growth in services.[2] This growth reflects long-term trends: the percentage of service jobs nationally has been increasing steadily.[3]

Nonetheless, services jobs are not completely immune to cyclical forces. Their vulnerability has been reflected in slower growth rather than absolute decline. Since World War II the services sector has grown only 3.5 percent more (average annual growth) during periods of expansion than during periods of contraction. The goods-producing industry, in contrast, fluctuated much more, showing a 12.4 percent difference in growth rates from contractions to expansions.[4]

Employment in transportation, communication, and public utilities (Chart 2) has held fairly steady, with modest job growth early in the recession and a slight decline in recent months. Communications and public utilities employment grew in the five District states for which specific data are available. Transportation, which accounts for the majority of jobs in this sector and which has been undergoing structural changes in the wake of deregulation, apparently accounted for most of the employment volatility.

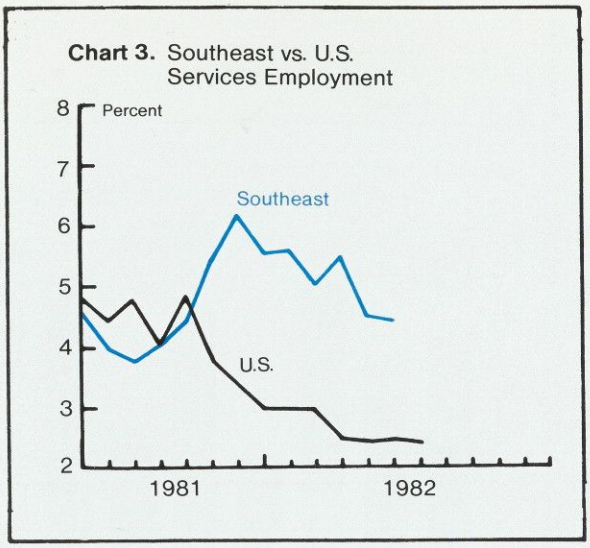
Government employment remains below recent historical levels (see Chart 1). Recent fluctuations in government employment are typical, even during recessions. The seemingly erratic month-to-month changes of late reflect the uncertainty associated with federal spending cuts as well as the recession's effect on personal income, sales taxes, and other sources of state and local revenues.

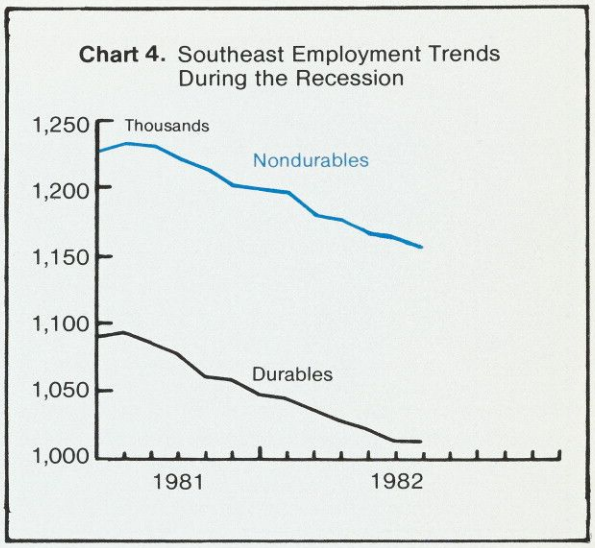
Construction is the only other nonmanufacturing sector to have lost jobs (see Chart 2), but neither construction nor government has slumped to

[1] Data for this study were drawn from the "establishment" survey conducted by the Bureau of Labor Statistics (BLS) of the U.S. Department of Labor in cooperation with related agencies in the 50 states. This series estimates nonagricultural employment by a sample of establishments which report payroll, employment, hours, and earnings by industry and geographic location to the various state agencies. Employment data are classified according to the primary product or activity performed by the reporting establishment. Taxonomic methods conform to the major categories in the 1972 Standard Industrial Classification Manual: manufacturing; construction; transportation, communication, and public utilities; trade; finance, insurance, and real estate; services; government; and mining. Manufacturing employment includes production of both durable and nondurable goods. The major categories of durable goods include lumber and furniture; stone, clay, and glass; primary metals; fabricated metals; machinery (electrical, electronic, and nonelectrical); transportation equipment; and instruments. The major categories of nondurables are food and kindred products, textiles, apparel, paper, printing and publishing, and chemicals.

The resultant estimate of "establishment" employment, which covers approximately 95 percent of nonagricultural workers, includes wage and salaried employees as well as full-time and part-time workers. It does not cover proprietors, self-employed, farm workers, domestic workers, or military personnel (see "Explanatory Notes," **Employment and Earnings**, 29, 6 (June, 1982), pp. 132-152.

Agricultural employment is estimated by the U.S. Department of Agriculture Crop Reporting Board on a quarterly basis. It covers both hired farm workers and family workers including those under age 16. Some of those




levels of the 1980 recession. Florida has experienced the most substantial cutbacks in construction employment as a result of past overbuilding and high interest rates. Employment in these two sectors has declined at the national level as well.

Manufacturing jobs have been hurt more by the recession. During the first 12 months of the recession, more than 150,000 manufacturing jobs were lost in the Southeast. Printing and publishing was the sole manufacturing industry to have increased employment (see Table 1). This industry has enjoyed steady long-term growth with only seasonal declines in monthly employment levels since the 1973-75 recession.

To understand the importance of small or even stable growth, we need to examine job attrition in declining sectors. Durable goods employment is very cyclical. Workers producing durable goods are estimated to be 2½ times more likely than nondurable workers to lose their jobs during a recession.[5] Nonetheless, the number of sectors now registering historically low employment reflects the depth and breadth of this recession. In several housing related sectors–lumber and wood products; furniture; stone, clay, and glass; and primary and fabricated metals manufacturing—the current trough is lower than in 1980. Since lumber and furniture manufacturing are major sources of industrial jobs in the region (see Box), the impact of this decline is considerable. Moreover, the number of jobs in stone, clay, and glass and in primary metals manufacturing is close to the trough of the 1973-75 recession.

Employment in other durable goods industries, including machinery and transportation equipment, has also fallen, although not to the low point of the 1980 recession. However, declines in machinery are significant because that category, the largest durable sector, includes electrical and electronic equipment.[6] Since electronics manufacturing is one component of high-technology widely regarded as the fulcrum of future U.S. economic growth, this trend confirms the seriousness of the recession.

Nondurable goods industries including textiles, apparel, paper, chemicals, and food production have also experienced job loss (see Chart 4). The decline in these sectors is noteworthy because,

counted may hold two jobs and others may be doing farm work only temporarily. Because of the considerable differences in the methods of estimating agricultural and nonagricultural employment, making comparisons between the two series is difficult. Moreover, until July, 1982, the Crop Reporting Board had not published a survey since 1980. Agricultural employment trends in the Southeast during the current recession have not been analyzed because of the long-term decline in this sector's importance as a source of jobs and because of the unavailability of comparable and current data.

[2]"News" of hiring in the growth sectors is far less frequent than reports of layoffs and plant shutdowns in adversely affected industry. One reason is that small establishments predominate in two growth sectors: trade and service. Michael Urquhart, "The Services Industry: Is it Recession-Proof?" **Monthly Labor Review**, 104, 10 (October, 1981), pp. 12-18.

[3]Even within the goods-producing sector the number of workers performing service-type activities has grown from 19 percent in 1939 to 32 percent today. (Wall Street Journal, January 15, 1982, p. 44.)

[4]*Ibid.*

[5]Noel D. Uri and J. Wilson Mixon,"The Effect of Exports and Imports on the Stability of Employment in Manufacturing Industries in the United States," **Applied Economics** 15, 2 (June 1981), pp. 198-201.

[6]To test whether the small decline in this category was an artifact of combining employment figures for nonelectrical, electronic, and electrical machinery production the first category was tabulated separately. The results showed that jobs were lost in each of the two disaggregated categories although nonelectrical machinery fared slightly worse.

## DISTRIBUTION OF EMPLOYMENT

Manufacturing employment is relatively less important in the southeastern economy than in the nation as a whole (see Chart A). In 1981 manufacturing accounted for 20.1 percent of the Southeast's nonagricultural establishment employment but 22.1 percent of U. S. nonfarm employment.

However, regional averages mask important differences among states in the Sixth District. The work forces of these six states vary in size. Florida accounts for nearly one-third of all nonagricultural employment in the District, while Mississippi claims only 7.2 percent of the nonfarm jobs. Manufacturing jobs in Florida and Louisiana contribute only 12.5 and 13.3 percent to the respective state's employment. In the other four states in the Sixth District—Alabama, Georgia, Mississippi, and Tennessee—manufacturing claims a larger share of total jobs than in the United States: 26.6, 23.8, 27, and 27 percent, respectively. Indeed, the economies and job structures of Tennessee and Alabama are similar to those of many states in the industrial heartland, with mature industries producing steel, autos, and home appliances, such as heating, air conditioning equipment, and stoves.

**Chart A.** 1981 Manufacturing Employment as Percentage of Nonfarm Employment

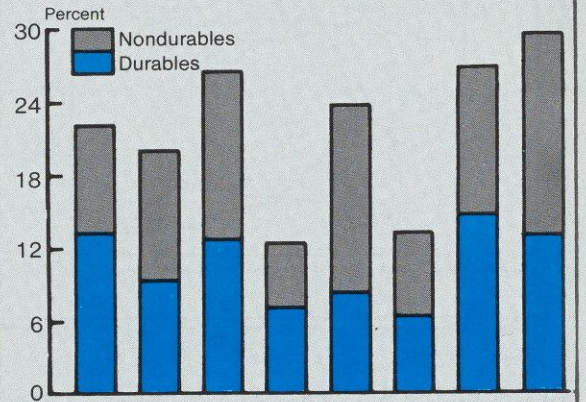
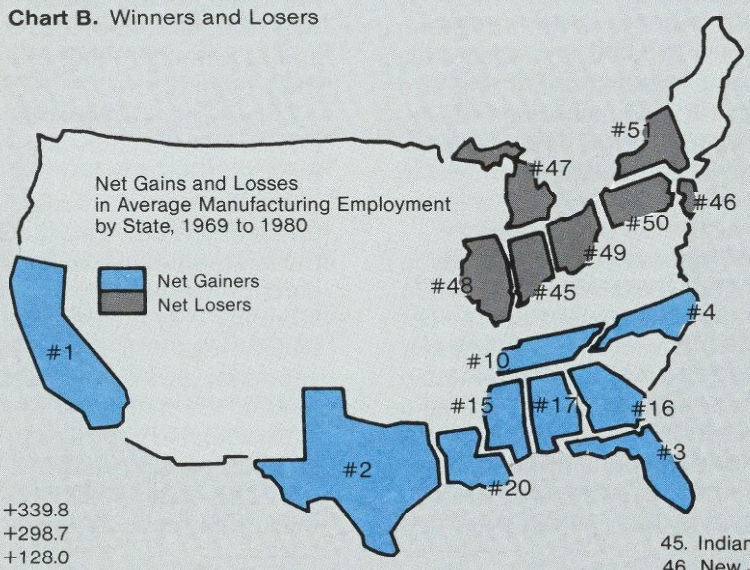



**Chart B.** Winners and Losers




**Winners**

1. California..... +339.8
2. Texas..... +298.7
3. Florida..... +128.0
4. North Carolina..... +10.2
10. Tennessee..... +45.0
15. Mississippi..... +38.9
16. Georgia..... +38.6
17. Alabama[a]..... +344.7
20. Louisiana..... +27.6

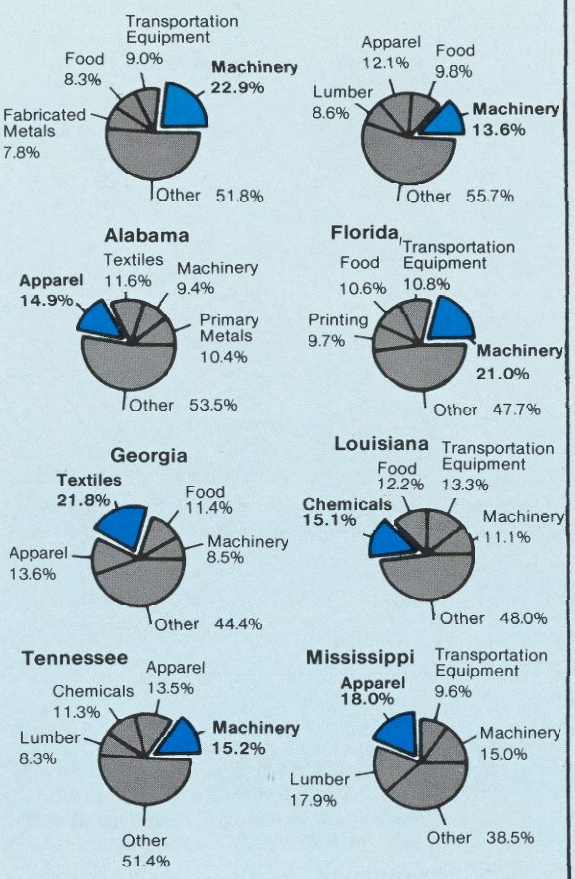
**Losers**

45. Indiana[a]..... −94.3
46. New Jersey[a]..... −111.8
47. Michigan..... −185.9
48. Illinois..... −195.1
49. Ohio..... −203.5
50. Pennsylvania..... −251.4
51. New York..... −419.7

[a]On 1973 benchmark. Other states on 1979 benchmark.

Source: Bureau of Labor Statistics, U.S. Department of Labor, **State Government News**, 24, 8 (August 1981) p. 9.

**Chart C.** Employment Shares of Largest Manufacturing Sectors




Thus, at the state level manufacturing is relatively more important in the Southeast than in the rest of the Sunbelt, where it rarely exceeds 15 percent of nonfarm employment.[1] Moreover, the South has gained manufacturing jobs since 1969, whereas older industrial regions have been net losers (see Chart B). Florida ranked third in the nation in the net number of manufacturing jobs gained during the period. In 1981 Louisiana ranked second in the nation in the number of large manufacturing plants opened and first in large plant expansions, according to the Industrial Development Research Council, which tracks openings and expansions of more than $500,000.[2]

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[1]William K. Stevens, "Sunbelt Having Difficulty Living Up to Its Promise," **New York Times**, July 5, 1982.

[2]Wayne King, "Despite Success, Sun Belt Oil Patch is Finding It's Not Immune to Recession," **New York Times**, July 9, 1982.

Another difference between southeastern and national employment is the relatively greater importance of nondurable over durable goods production. Only in Mississippi do durables outrank nondurables as a percentage of nonfarm employment (see Chart A).

Chart C depicts the prominent role in southeastern employment of nondurable manufacturing, especially textiles, apparel, lumber, and furniture. In contrast, transportation equipment, fabricated metals, and printing and publishing account for a larger portion of the jobs in the nation. Machinery production is important in both the Southeast and the nation. Yet in the Southeast it contributes fewer than 3 percent of total nonagricultural jobs, compared with 5 percent in the United States.

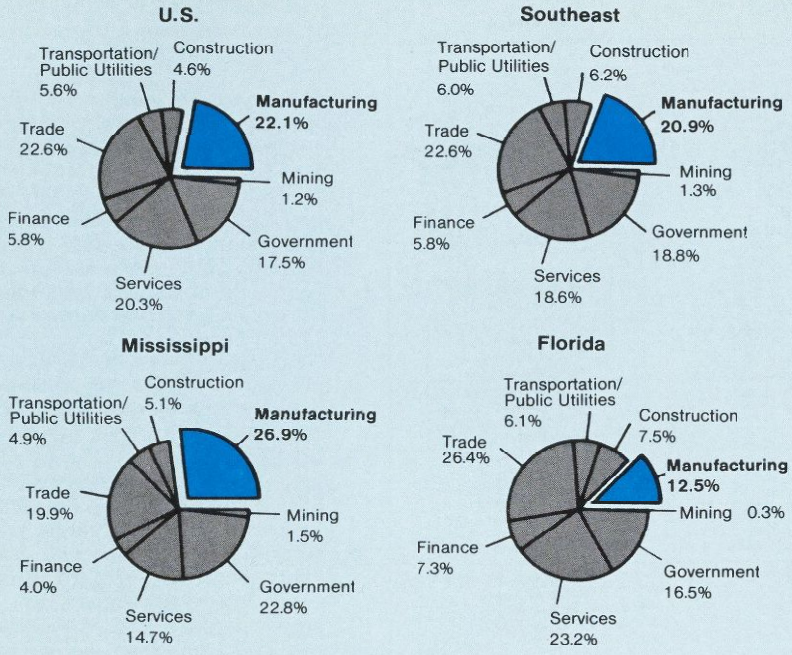
However, Chart C, also reveals considerable variation from state to state. For example, in Louisiana production of chemicals is the largest manufacturing sector, contributing 15.1 percent of goods-producing jobs. Louisiana and Florida have no textile employment, and apparel production is small in the former. In Mississippi, where lumber-related jobs dominate manufacturing, textile production accounts for a relatively small portion of jobs. Printing and publishing is concentrated in Florida and Tennessee.

Wholesale and retail trade is the largest single source of jobs in both the nation and in every state of the Southeast except Alabama and Mississippi, where it is outranked by government employment. About one in every five workers is employed in the trade sector (see Chart D). As a source of employment, the services category, including health, business, repairs, and recreation is nearly as important as trade. However, the Southeast lags behind the nation in the proportion of workers employed in this rapidly growing sector: 18.7 percent of southeastern jobs compared with 20.3 percent nationwide. Government employment is more important in the Southeast than in the nation. It is the single largest nonmanufacturing job sector in Alabama and Mississippi largely because of employment related to military installations.

The category of finance, insurance, and real estate (hereafter termed simply finance) is a small but growing sector, which accounts for more than 5 percent of nonagricultural employment in both the Southeast and the United States. Construction jobs are proportionally more numerous in the Southeast than in the nation; construction contributed an average of 6.2 percent of the Southeast's jobs in 1981, but only 4.7 percent of the nation's. This contrast is understandable since construction employment is spurred by the kind of rapid population growth that the South has enjoyed during the last decade. Construction employment is most important in Louisiana and Florida, where it contributed 8.9 and 7.6 percent of the nonfarm jobs respectively.

Transportation, communication, and public utilities jobs also comprise a slightly larger component of southeastern than of national employment, especially in Florida, Georgia, and Louisiana, where the airline industry is a major employer.

**Chart D.** 1981 Nonfarm Employment by Sector




*Florida and Mississippi demonstrate the diversity of employment in the region.

Agricultural employment is less than 4 percent of total employment. This proportion prevails in most Sixth District states except Mississippi and Tennessee, where farm workers constitute an estimated 7.6 and 5.5 percent of total employment.

In general, nondurable goods manufacturing, construction, transportation, (including communication and public utilities,) trade, and government contribute a relatively larger portion of jobs in the Southeast than in the nation, whereas durable goods production, finance and services contribute a somewhat smaller portion of jobs to the region's economy than to the nation's.

except for textiles, nondurables are less cyclical by virtue of their lower inventory levels. Moreover, jobs in textiles, apparel, and food production have fallen to levels below those in the past recession, and textiles employment is lower than in 1973-75.[7] Such sectors as textiles and apparel have been experiencing declines as a result of low-cost foreign competition. Although such declines during a recession are not unusual, they are significant because apparel accounts for so many manufacturing jobs in the Southeast (see Box).

## Employment Prospects in the Coming Months

Our telephone survey of southeastern industry representatives indicates that the employment outlook in the months ahead is not promising.[8]

[7]Trends in the nation are the same or worse than in the Southeast. Employment in four sectors—stone, primary metals, textiles, and apparel—is below 1975 levels, and in three others—fabricated metals, transportation equipment, and food—it is close to those low points. In the Southeast only textile jobs are below 1975 levels, and only stone and primary metals are near those levels. Moreover, in the nation the number of jobs in textiles, apparel, stone, and primary metals is at the lowest point since 1969.

[8]This telephone panel consisted of representatives of over 75 firms and several trade associations. Interviews were conducted during the last two weeks of September. The sample was "stratified" to resemble the employment distribution in the District.
For example, since the government sector accounts for nearly 20 percent of the jobs in the Southeast, approximately one-fifth of the rspondents were drawn from government agencies based here. In order to avoid very small

**Table 1.** S.E. Employment Trends During the Recession—Seasonally Adjusted (thousands)

| Sector | July 1981 | September 1982 P | Percent Change (15 month) |
|---|---|---|---|
| Construction | 707.3 | 649.9 | −8.1 |
| Transportation* | 700.6 | 691.2 | −1.3 |
| Finance** | 631.0 | 630.2 | −0.1 |
| Trade | 2,673.3 | 2,683.3 | 0.4 |
| Services | 2,152.4 | 2,246.2 | 4.4 |
| Government | 2,135.3 | 2,143.2 | 0.4 |
| Manufacturing | 2,314.4 | 2,139.4 | −7.6 |
| Lumber | 134.0 | 120.5 | −10.1 |
| Stone | 76.3 | 68.7 | −10.0 |
| Primary Metals*** | 100.0 | 82.2 | −17.8 |
| Fabricated Metals*** | 130.4 | 119.1 | −8.7 |
| Machinery | 321.1 | 295.3 | −8.0 |
| Transportation Equipment | 185.4 | 170.3 | −8.1 |
| Food | 225.1 | 222.2 | −1.29 |
| Textiles | 192.1 | 170.8 | −11.1 |
| Apparel | 273.4 | 264.3 | −3.3 |
| Paper | 105.1 | 99.9 | −5.0 |
| Printing & Publishing | 122.3 | 125.4 | 2.5 |
| Chemicals*** | 154.8 | 145.9 | −5.8 |

P Preliminary

*Includes communication and public utilities.

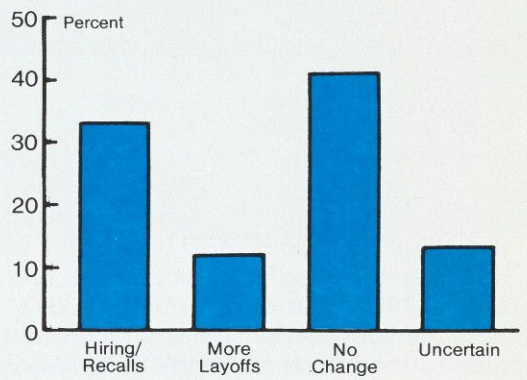
**Includes insurance and real estate.

***Not seasonally adjusted

Although many respondents expressed optimism that the recession had passed its trough, few felt confident that recovery is underway or imminent, and almost none had definite plans to increase hiring.

Of those surveyed, most (41 percent) foresaw no change in the near-term employment outlook. They felt their firms would neither lay off more employees, nor recall furloughed workers, nor hire additional personnel in the next few months (see Chart 5). Thirteen percent of the sample was quite uncertain about the employment outlook; such respondents projected either further reductions or additions to their work forces according to the vagaries of the economy. Only 12 percent envisioned additional layoffs. However, representatives of various industries said they would seek reductions through attrition: new

**Chart 5.** Employment Outlook of Industry Respresentatives
(Possible or Probable Plans for Coming Months)




"cells" within certain sectors, such as manufacturing, finance, and transportation, which have distinct subdivisions, these categories were moderately overrepresented in the sample. Even so, conclusions about hiring prospects in particular industries must be regarded as tentative. The sample can be construed to be representative of the largest establishments within each industry because it was drawn primarily from **Fortune Magazine's** leading firms as measured in sales or assets and from firms with the largest work forces. The sample was comprised primarily of publicly held businesses based in the Southeast, but some smaller firms, a few private corporations, and a number of branches of firms headquartered elsewhere were also polled. Together these firms employ approximately 800,000 workers in the Southeast.

employees would be added only selectively to replace workers who resigned or retired.

While nearly one-third of our sample expressed optimism about the employment outlook, virtually all stressed that their hiring would be "slow" or "conservative." In several instances representatives described anticipated increases as merely possible or seasonal. Moreover, many positions to be filled would require technical and professional skills. Even defense-related firms expected no marked growth in operational employment until almost 1984. Firms that have won contracts must gear up before large-scale hiring of construction and production workers can begin.

The strongest harbingers of job growth appeared in finance, services, and in defense- and computer-related segments of manufacturing industries. Job growth appears possible in a variety of other industries including apparel, printing, construction, transportation, communication, public utilities, retail trade, and services. However, even in these growth industries many respondents described the near future as a period of employment consolidation rather than expansion. Such firms had introduced measures to reduce costs, increase efficiency, and, in some instances, help employees displaced by automation to upgrade their skills for employment elsewhere in the organization. Sectors in which further job reductions are possible include government, mining, public utilities, and the manufacture of transportation equipment, textiles, apparel, and chemicals.

Most respondents (45.7 percent) said they had no idea when a recovery might begin. Approximately 14 percent of those polled believed that recovery, at least in their industries, was underway or would begin before the end of 1982. An equal number felt the economy would pick up during the first quarter of 1983. Ten percent foresaw recovery starting in the second quarter of 1983 and 5.7 percent pointed toward the third quarter of next year. Ten percent doubted that recovery would get underway before 1984. The most optimistic view came from the construction, transportation, and communication industries. Nearly all representatives of these sectors felt that recovery was incipient or imminent. The most pessimistic outlook was expressed by representatives of public utilities.

Since the sample is weighted toward more successful corporations within each sector (see footnote 7), the limited hiring foreseen in the months ahead is inauspicious in the short run for the southeastern economy. However, the optimism expressed from the construction industry bodes well for the middle term since so many industries are related to housing and since the comparatively high wages of construction workers generate additional jobs.

## Long-Term Outlook for Employment

Recessionary employment trends in the Southeast generally are parallel with, though less extreme than, trends in the nation. Therefore, one way to predict future southeastern employment trends is to examine forecasts for the United States. According to Bureau of Labor Statistics forecasts, the number of jobs in durable goods production—particularly typewriters, office equipment, and medical and dental equipment—should grow through 1990, stimulating demand for steel and boosting jobs in primary and fabricated metals.[9] In contrast, the BLS predicts, employment in textiles, apparel, and food processing will decline (see Table 2).

The Southeast should share in this manufacturing employment growth. Indeed, in Georgia manufacturing employment is predicted to show the greatest rebound of any employment sector in the state from 1983-84; transportation equipment, primary and fabricated metals, and lumber and furniture should expand the most.[10] The Southeast, with its timber resources, is becoming the center of the lumber, pulp, and paper industry. This shift was one reason Georgia Pacific Corporation transferred its corporate headquarters to Atlanta earlier this year from Portland, Oregon.[11] The Southern Growth Policies Board, a research organization of 12 southern states, predicts that by the year 2030 the Southeast will produce 56 percent of the nation's hardwood and 59 percent of its softwood.[12] Electrical machinery and instruments should be Florida's fastest growing job sector through 1985,[13] and Tennessee expects strong growth in transportation equipment jobs, although not until 1983-85 when a Nissan truck plant begins production.[14]

Increased defense spending should also boost southeastern manufacturing employment, particularly in Florida, Mississippi, and Georgia. The

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[9] Valerie A. Personick, "The Outlook for Industry Output and Employment Through 1990," **Monthly Labor Review**, 104, 8 (August 1981) pp. 28-41. See also John Hekman and Alan Smith; "Behind the Sunbelt's Growth: Industrial Decentralization," this **Review** (March 1982, pp. 4-13).

[10] Georgia State University, Economic Forecasting Project, August 1982. Much of this improvement is due to Congressional approval of the C5-B, which will be produced by Georgia-based Lockheed.

**Table 2.** Low-Trend Projected Employment Changes for Selected Industries, 1979-90

| Fastest Growing | Average Annual Rate of Job Growth (percent) |
|---|---|
| Other medical services | 4.6 |
| Typewriters and other office equipment | 4.5 |
| Computers and peripheral equipment | 4.2 |
| Coal mining | 4.1 |
| Hospitals | 3.8 |
| Crude petroleum and natural gas | 3.6 |
| Doctors' and dentists' services | 3.4 |
| Local government passenger transit | 3.3 |
| Other state and local government enterprises | 3.2 |
| Automobile repair | 3.1 |
| **Most Rapidly Declining** | **Average Annual Rate of Job Decline** |
| Dairy and poultry products | −3.3 |
| Alcoholic beverages | −3.1 |
| Leather tanning and industrial leather | −2.7 |
| Logging | −2.4 |
| Synthetic fibers | −2.1 |
| Other agricultural products | −1.8 |
| Railroad transportation | −1.7 |
| Wooden containers | −1.6 |
| Dairy products (processed) | −1.6 |
| Bakery products | −1.5 |
| **Largest Job Gains** | **Employment Gain (in thousands)** |
| Eating and drinking places | 1,912 |
| Retail trade, except eating and drinking places | 1,878 |
| Hospitals | 1,347 |
| Miscellaneous business services | 1,171 |
| Other medical services | 909 |
| New construction | 892 |
| Wholesale trade | 866 |
| Doctors' and dentists' services | 580 |
| Banking | 490 |
| Educational services (private) | 416 |

Source: "Industry Output and Employment Projections," **Monthly Labor Review,** August, 1981, p. 40.

southern share of defense contracts was 25 percent in 1976, up from 11 percent in 1951. Lockheed-Georgia's Marietta plant is gearing up to produce as many as 50 C-5B cargo transports under a $50 million preproduction contract approved in October by the Air Force, although the first plane will not roll off the assembly line until 1986. Congressional approval of a final $9.3 billion contract could bring thousands of jobs to the area. McDonnell-Douglas has announced plans to hire 300-400 additional workers to meet a new government contract. Moreover, such defense contracts historically have engendered a "spillover" of high-technology jobs, particularly

[11] **Atlanta Constitution**, August 20, 1982, Section 3, p. 2.
[12] E. Evan Brunson, "The Global 2000 Study: Implication for the Future of the South," Research Triangle N.C.: Southern Growth Policies Board, 1980.
[13] **Florida Employment Directions: Industries and Occupation, 1974-1985** (Tallahassee, Florida: Florida Department of Commerce, 1977), p. 13.
[14] Richard Hofler, *et al.*, "Outlook for Specific Industries," **Survey of Business**, 17, 3 (Winter, 1982), pp. 21-30.

in central Florida and in the Huntsville, Alabama, area.[15]

Finance, trade, and services, which have sustained growth during the current recession, should continue to generate jobs. State of Florida projections cast finance, insurance, and real estate as the source of fastest job growth through the year 2000 but do not anticipate such high growth in the near term.[16] Miami's focus as the center of international banking, Jacksonville's strength as an insurance center, and general population growth fostering widespread real estate development contribute to this optimistic view. After winning Medicare contracts for two additional counties earlier this year, for instance, Blue Cross of Jacksonville hired 143 new employees. The BLS expects trade to show the greatest absolute growth nationally because of its initial large size; it predicts that employment in services will grow at the fastest rate nationally.[17]

A countervailing factor is the fact that job growth in services is thought to depend on growth in manufacturing. Since most services are marketed locally and cannot be "exported" to other regions, their profits do not generate net regional gains.[18] In contrast, manufactured products can be sold outside the region.

Much of the Southeast's rapid postwar economic growth has exemplified the hypothesis that rising per capita income is the result of workers shifting out of agriculture, forestry, fishing, and mining into manufacturing and services. Southeastern farm employment seems to be stabilizing, except in Mississippi, where the decline continues at a rapid pace. Moreover, services and trade now claim almost as great a share of jobs in the Southeast as in the United States. Future employment growth in trade and services is less likely to stimulate the Southeast's personal income growth since the strength of the relationship in the South has declined markedly since 1940.[19] Sustaining the region's high growth rate apparently will depend increasingly on growth within higher-paying categories of the goods-producing sector and on expansion of resource industries.

**Table 3.** Southeast's Share of Corporate Headquarters, 1971 vs. 1981

| | 1971 | | 1981 | |
|---|---|---|---|---|
| | Number | Percent | Number | Percent |
| Manufacturing | | | | |
| Fortune's top 500 | 10 | 2.0 | 19 | 3.8 |
| Fortune's second 500 | 26 | 5.2 | 35 | 7.0 |
| Trade* | 2 | 4.0 | 4 | 8.0 |
| Finance** | 1 | 1.0 | 3 | 3.0 |
| Insurance | 3 | 6.0 | 4 | 8.0 |
| Transportation* | 4 | 8.0 | 3 | 6.0 |
| Utilities | 2 | 4.0 | 5 | 10.0 |
| Service* | N.A. | N.A. | 5 | 10.0 |

*Top 50
**Top 100

On the other hand, employment growth in services may not yet be nearing its peak. In the last 10 years the Southeast has substantially increased and diversified its share of major corporate headquarters, as illustrated in Table 3. Whereas in 1971 only 10 of **Fortune's** leading 500 manufacturers were headquartered in the Southeast, by 1981 fully 19 of the top industries were based in Alabama, Florida, Georgia, Louisiana, Mississippi, and Tennessee. Similar growth occurred in the non-goods sector. While New York, Illinois, California, Pennsylvania, Ohio, and Connecticut continue to dominate industrial headquarter locations, southeastern growth is important because corporate headquarters tend to offer jobs that are more lucrative and challenging. Functions such as research and development, finance, and corporate planning are typically performed at the home office. Furthermore, firms providing support services tend to cluster around headquarters.[20]

[15]Philip K. Rones, "Moving to the Sun: Regional Job Growth, 1968-78," **Monthly Labor Review**, 103, 31 (March, 1980), p. 14.

[16]**Florida in the Year 2000** (Tallahassee, Florida: Florida Department of Labor and Employment Security, 1981), p. 17.

[17]Personick, *op. cit.*

[18]Lawrence Falk and Adam Broner, "Specialization in Service Industry Employment as a State Policy," **Growth and Change**, 11, 4 (October, 1980), p. 18. Tourism is one exception. The South attracts more tourists from other regions than it sends. Consequently, tourist revenues represent a net gain for the region.

[19]William H. Miernyk, "The Changing Structure of the Southern Economy," in **The Economics of Southern Growth**, edited by E. Blaine Liner and Lawrence K. Lynch (Research Triangle, N.C.: Southern Growth Policies Board 1977), pp. 57-60. This hypothesis was first advanced by Allen G. B. Fisher and Colin Clark, working independently, in the 1930s and 1940s.

[20]Thomas M. Stanback, Jr., **Understanding the Service Economy: Employment, Productivity, Location**. Baltimore: Johns Hopkins Univeristy Press, 1979, p.88.

## Challenges to Employment Growth

Employment growth in the Southeast faces several challenges. Because the region claims such a large proportion of the nation's textile and apparel plants, predicted job reductions in these sectors should have a great impact. In addition, the region may be outdistanced by areas with proportionately more durable goods production. The Southeast's "specialization" in nondurable goods often has protected it against cyclical fluctuations. However, nondurable industries, slower growth rates and lower wage levels have also constrained the region from more rapidly narrowing the gap in personal income. Despite its increasing prosperity, most of the South continues to lag in personal income. From 1974 to 1980 southern per capita income as a proportion of national personal income rose only 0.1 percentage point to 85.8.[21]

In addition to the region's industry mix, factors such as energy, demography, and education will influence future manufacturing employment in the Southeast. Since nondurables are more energy-intensive, the region could be affected severely by rising energy costs.[22]

Another potential limitation to regional manufacturing employment growth is the region's comparatively poor educational levels. One factor in the Southeast's growth during the past several decades has been its low wage structure. Low wages were consonant with the region's large pool of unskilled, undereducated workers. Forty percent of southern adults lack high school diplomas, whereas in the rest of the United States only 31 percent have not completed secondary school.[23] Great progress has been made during the last decade in the region's general education. Technical training, however, still lags.

A third potential constraint on long-term job growth is demographic. In past decades, rapid population growth and increasing participation in the labor force have expanded the southeastern labor supply to meet increasing demand without inflating wages. From 1970 to 1980 population in the South grew twice as fast as in the rest of the country. Sixty percent of this increase was due to net in-migration. The elasticity of the region's labor supply was also favored by a rapid increase in the number of women seeking jobs. Yet increases in regional labor participation rates may have peaked. Consequently, additional economic growth and increased demand for labor may face a comparatively inelastic supply. That trend could apply upward pressure on wages, and erode one of the region's comparative advantages in attracting industry.[24]

Expansion of trade and service jobs is tied to population growth also. Migrants from other regions of the United States have tended to be better educated and to garner higher personal incomes. They have been especially responsible for the rapid growth of trade and services jobs. However, recent research calls into question whether migration rates will continue. Florida, for example, is unlikely to monopolize migration from the Northeast and North Central as it has in the past three decades. If population growth slows as predicted, it may slow the rate of job expansion in services and trade.

Demographic changes are likely to continue their downward pressure on government employment. The maturation of the "baby-boom" generation, its lower fertility rate, and the consequent declining enrollment in schools have already reduced demand for teachers and slowed the growth enjoyed by the government sector during the 1960s and most of the 1970s.[25] Political factors such as the New Federalism and growing opposition to increasing taxes should magnify the influence of demographic shifts, at least in the short run. Federal budget cuts should severely affect the Southeast because heretofore it has gained more than it has contributed in federal revenues. In addition, local tax structures are likely to constrain state and local governments from taking steps to offset reduced federal spending.[26] On the other hand, by increasing

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[21] **Southern Growth**, 10, 1 (Summer, 1982), page 6. This average encompasses Arkansas, Kentucky, North Carolina, South Carolina, Oklahoma, and Virginia as well as the states of the Sixth Federal Reserve District. Average per capita income relative to national norms actually declined after peaking at 86 percent in 1978.

[22] Brunson, *op. cit.*; James T. Fergus, "Energy Dependence and Southeastern Economic Growth: An Input-Output Analysis," **Economic Review** (Atlanta), (Sept./Oct. 1977) Fergus estimates that coal plays such a minor role in the present energy mix that this energy source is likely to have very little impact even on durable goods manufacturing (see especially pp. 109-110).

[23] **Southern Growth**, *op. cit.*

[24] Gregory Jackson, *et al., Regional Diversity: Growth in the United States, 1960-1990*, Boston: Auburn House Publishing Company, 1981, pp. 18, 37 44, and 61; Lynn E. Browne, "Regional Unemployment Rates: Why are They so Different?" **New England Economic Review**, (July/August 1978), p. 17.

[25] John T. Tucker, "Government Employment in an Era of Slow Growth," **Monthly Labor Review**, 104, 10 (October, 1981), p. 23.

[26] For instance, Tennessee relies on sales, interest, and dividends taxes. Consequently, personal and corporate economic growth are poorly translated into increased state revenues. (Hofler, *op. cit.*)

**Table 4.** State Shares of Key Sectors, 1981*

| Southeast Employment (%) | Ala. | Fla. | Ga. | La. | Miss. | Tenn. |
|---|---|---|---|---|---|---|
| Total Nonfarm | 11.8 | 32.6 | 19.1 | 14.2 | 7.2 | 15.1 |
| Services | 10.3 | **40.5** | 16.8 | 13.4 | 5.9 | 13.9 |
| Trade | 10.2 | **43.2** | 19.0 | 13.8 | 6.2 | 13.9 |
| Finance | 9.4 | **37.0** | 18.1 | 12.0 | 5.2 | 12.2 |
| Printing and Publishing | 8.3 | **37.1** | 19.6 | 7.8 | 4.7 | **22.5** |
| Construction | 9.5 | **39.8** | 14.4 | **20.4** | 5.9 | 10.0 |
| Trans., Comm., and Public Utilities | 10.2 | 32.9 | 20.6 | **18.7** | 5.8 | 11.7 |
| Durables | **16.1** | 24.7 | 18.1 | 9.8 | **11.4** | **21.0** |
| Nondurable | **15.2** | 16.5 | **27.6** | 9.2 | 8.1 | **23.4** |

*"Over represented" sectors are printed in boldface.

taxable income and sales, recovery itself should add to government revenues and thereby increase hiring.

Foreign competition may present another challenge to the long-term growth of many nondurable sectors. Over one-fourth of apparel sold in the United States is produced abroad, and the foreign market share is increasing, according to the Commerce Department's International Trade Administration.[27] On the other hand, certain segments of the textile and apparel industries, such as carpets, rugs, towels, and bedding products, are likely to follow a budding recovery in the housing industry. Furthermore, the longer term prospects for textiles—and, to a lesser extent, apparel—show signs of improvement through expansion and product diversification, better management, consolidation, and automation.

Although the textile and apparel industries might offer fewer low-wage, production line jobs, they may need more managerial and technical personnel. Recently, for instance, Mahasco Corporation completed the transfer of its carpet division headquarters to Atlanta from Amsterdam, New York, and hired 133 local employees in addition to the 79 senior management and technical personnel who moved from New York. This changing composition of textile employment should upgrade wage levels and generate jobs in other sectors. The number of southeastern-based textile and apparel firms ranking in **Fortune Magazine's** listing of the top 1,000 publicly owned industrials increased 37.5 percent from 1971 to 1981.

Because the Southeast is not a homogenous unit, sectoral employment growth and attrition will affect each state in the District differently. Florida can expect to enjoy most of the job growth because sectors, such as services, that have grown during the recession and which are predicted by most analysts to continue growing are "overrepresented" in Florida (see Table 4). Even within certain states the effects of growth will be distributed unevenly. For example, Atlanta accounts for nearly three-quarters of Georgia's business services jobs and thus will enjoy most of the growth in this rapidly growing sector.[28]

Summing up, an analysis of trends during the current recession, a review of academic literature, and a poll of industry representatives all point to finance and services as sources of future employment growth in the Southeast. Job expansion also appears likely in construction, retail trade, and mining, and in certain manufacturing sectors, such as lumber, electronics, shipbuilding, and printing and publishing. However, the onset of growth in these sectors is less predictable.

**—Bobbie H. McCrackin**

*Sandra L. Davis provided valuable research assistance on this project.*

[27] **Atlanta Constitution,** October 6, 1982, Section 3, pp. 1, 9.

[28] **Southeast Economic Perspective,** June, 1981, p. 16.

# Sources of Bank Capital: An Issue for the 80s

As the 1980s unfold we undoubtedly will see a different banking industry. The forces of market deregulation that brought new market rate deposit accounts, distant loan production offices and interstate automatic teller machine (ATM) networks over the past decade will continue to bring dynamic changes to banking. Deregulation will also bring more competitors. Thus, banks must be prepared for the possibility of lower profit margins and lower earnings during the 80s.

If banks try to raise capital during this decade the way they have since the early 70s, lower bank earnings could have serious consequences for the industry. Well over three quarters of the banking industry's equity capital growth since 1970 has come from retained earnings. If during the 80s banks can no longer depend on strong earnings and if they must meet fixed capital to asset requirements, they will have to find other means to support asset growth. If these other means of capital generation are not feasible, the remaining alternative would be to restrict asset growth itself, putting banks facing new entrants into the banking industry at a competitive disadvantage (see "Regulating Bank Capital", p.66).

## Sources of Capital Growth

To maintain a particular capital postition relative to asset size, a growing bank must maintain capital growth at least equal to its asset growth. For banks that start without excess capital, any slowdown in growth in capital would cause capital ratios to decline and bring criticism from bank regulatory authorities. A declining capital position could also cause a certain "market punishment" if the bank's stock and liabilities-such as large CDs and debentures—are traded. Market forces may drive the stock price down or rates on liabilities up to a level that would provide an investor a higher yield to compensate for any additional risk due to lower capital.

Banks' sources of capital may be divided into two parts, internal and external. The most important is internal capital generation, a function of bank profitability and earnings retention rates. It is derived simply by computing a bank's net income after taxes plus net additions to loan loss reserves, less any dividends it pays to shareholders. External capital generation, the second source of capital, is derived from sources outside the

**Banks traditionally have been very dependent on internal capital growth. If deregulation brings lower earnings to the industry, regulatory capital guidelines may force some banks to restrict asset growth to compensate for slower internal capital growth.**

organization. The most common source of external capital is the sale of common stock.

Another source of capital is the sale of preferred stock, a minimal source over the years principally because of the unfavorable treatment of dividends for tax purposes. Dividends on common and preferred stock are considered an after-tax distribution of a firm's earnings, so a bank receives no tax benefit from dividend payments. For this reason a third source of external capital, debt capital, has been more popular than preferred stock. Interest payments on debt are tax deductible, making debt less costly to the bank in many cases than preferred stock. Debt capital is entirely different than the other two sources of external capital. Unlike internal and preferred and common stock capital, debt capital is not considered a part of the bank's equity. The other capital sources are considered to be permanent, while debt capital must be repayed at a future date. Under the new capital guidelines outlined in the joint Federal Reserve/OCC policy statement, debt is recognized as a partial buffer to protect deposits; however, it is not considered capital unless it has an original maturity of at least seven years. As the maturity of a debt draws near, it is phased out of the banks' capital structure in the regulators' analysis of capital adequacy.

The role of debt as capital has been debated for many years. The central issue has been, "Does debt capital possess the buffer-like qualities of equity capital and should it be considered capital?" From the depositor's viewpoint it does serve as a cushion against losses. Debt capital is subordinated to the rights of depositors in the event of bank insolvency and would be second in line after equity capital to absorb losses before any depositors lost their principal. At the end of 1981, debt capital was subordinate to virtually all bank liabilities. But what about holders of the debt? They are liability holders of the bank just as depositors are and yet have less protection against losses. The holder of subordinated debt must rely solely on equity capital to protect against losses.

## REGULATING BANK CAPITAL

Capital serves as a buffer to protect depositors and creditors against losses on loans or other assets held by a bank. Regulators impose strict requirements on commercial banks to maintain capital levels sufficient to absorb any such losses, fearing that one failure can endanger the public's faith in the entire system. Bankers generally argue for lower capital requirements and less regulation; if a bank can operate with less capital per asset dollar, then it can increase its return on equity (ROE)—the rate of return a bank earns for its shareholders. This method of increasing ROE is known as leveraging.

Depositors' risk of loss due to inadequate capital is mitigated somewhat by the Federal Deposit Insurance Corporation, which insures deposits up to $100,000. Even large depositors' funds usually are saved because the FDIC will arrange for a failing bank to be acquired by a stronger institution whenever possible. However, the recent liquidation of Penn Square Bank in Oklahoma highlights the remaining risk to large depositors. As an insurer of deposits, the FDIC obviously is interested in capital adequacy as are bank creditors who must rely on capital to protect their interests.

Even at capital levels established by regulators, the banking industry is considered highly leveraged compared to most other industry averages. However, some other financial firms operate with even a higher degree of leverage. New entrants into traditional banking markets enjoy greater flexibility in their financial planning to meet customer demands. Bankers are concerned that regulations and capital restrictions enforced by regulators may leave them at a competitive disadvantage.

**Table 1.** Standard Capital-Asset Ratios (percent) in Newly Announced Policies of the Federal Regulatory Agencies

| | Federal Reserve-Comptroller* | | FDIC** |
|---|---|---|---|
| Zones | Regional Banks | Community Banks | All Banks |
| 1. (Acceptable) | 6.5 or more*** | 7.0 or more**** | 6.0 or more |
| 2. (Possibly Under capitalized) | 5.5 to 6.5 | 6.0 to 7.0 | 5.0 to 6.0 |
| 3. (Undercapitalized) | Less than 5.5 | Less than 6.0 | Less than 5.0 |

*May include debentures and limited-life preferred stock.
**May **not** include debentures or limited-life preferred stock.
***Primary capital must be greater than 5.0 percent of assets.
****Primary capital must be greater than 6.0 percent of assets.

## Internal Capital

Of the two sources of capital available, banks have depended overwhelmingly on internal capital generation. As shown in Table 3, equity capital has grown from $43.5 billion in 1969 to $129.3 billion at yearend 1981, an almost threefold increase. Of the approximately $85.8 billion increase in equity, more than $70.6 billion came from internal sources. This means that approximately 82.3 percent of the banking industry's equity growth came from earnings retention. Although internal generation is a function of bank profitability and retention rates, high bank profitability alone does not necessarily indicate strong internal capital generation. The amount of earnings an institution is able to retain after it has paid dividends to shareholders determines the degree of internal capital generation. If a banking firm pays out a high percentage of its income to shareholders, it will have less money to contribute to capital than a bank with identical earnings and a lower dividend payout. Table 4 indicates earnings retention rates since 1969. We see that in 1981 commercial banks in this country retained on average 60.45 percent of their net income—just slightly higher than the 59.05 percent in 1969. The 13-year average is 61.85 percent of net income.

Over the past decade, internal capital generation at commercial banks in the six states within the Sixth Federal Reserve District has shown considerable variation (see Table 5). Florida banks have depended least on internal sources of capital, which measured only 69.95 percent of that state's bank equity growth. This is no surprise considering the rapid economic growth of the Florida economy during the 70s. Bank stocks in high growth areas usually bring above average P/E ratios which may make external capital more readily available and encourage **de novo** banking. Because of slower growth of banking markets in Alabama and Mississippi, banks in both states had above-average dependence on internal capital growth—89.74 and 87.21 percent of total equity growth, respectively. Of all banks in the Sixth District, banks in Georgia were most dependent

**Table 2.** Distribution of Banks Within the New OCC/Federal Reserve Capital Adequacy Guidelines as of 12-31-80

| | Regional | Community |
|---|---|---|
| Primary Capital | 95%* | 97%** |
| Total Capital: | | |
| Zone 1 | 76% | 93% |
| Zone 2 | 21% | 5.5% |
| Zone 3 | 3% | 1.5% |

*Primary capital must be greater than 5.0 percent of assets.
**Primary capital must be greater than 6.0 percent of assets.

Source: Office of the Comptroller of the Currency

Regulators use certain capital ratios to help assess banks' capital adequacy. Capital ratios, though not absolute measures of capital adequacy, provide guidelines within which banks should operate. Current guidelines established by the Federal Reserve and the Office of the Comptroller of the Currency (OCC) call for fixed capital to asset ratios. In a joint policy statement, the Federal Reserve and OCC based their capital guidelines on asset size, treating the largest banking firms individually and considering the specific condition of the other institutions within the broader scope of the guidelines. The FDIC set separate guidelines for capital adequacy at banks under its supervision, similar to those set by the Federal Reserve/OCC. Table 1 sets forth the new "zones" of capital adequacy and their benchmark ratios. If a bank's capital ratios decline to the bottom two zones, regulators monitor its overall financial condition more closely and may require additional capital to maintain the institution's safe and sound operation.

Formulating the new guidelines, the OCC conducted a study to determine where bank capitalization stood in relation to the proposed guidelines as of December 31, 1980. Table 2 shows that the vast majority of banks met the primary as well as total capital requirements. Community banks appeared to possess slightly stronger capital positions than regional banks. Only 1.5 percent of community banks fell into Zone 3 compared to 3.0 percent of the regional banks.

The capital guidelines set forth by regulators create a barrier to the natural capital-to-assets ratio equilibrium that would normally exist in a free market. Regulators place capital requirements on banks because their concern reaches beyond the failure of just one bank and embraces the broader issue of the public's confidence in the entire banking industry. Without regulatory imposed guidelines the market place would be free to dictate capital levels and many banks might be able to lower capital ratios without facing any significant market punishment. However, even in an unregulated banking market, capital would "bottom out" at a level where uninsured depositors and creditors felt capital was not sufficient to protect against unforeseen losses. If capital dropped below the level that the market place considered safe, market forces would drive the bank's cost of capital as well as the rates paid on certain liabilities higher.

Maintaining specific capital ratios in a time of increased competition could present hardships for the banking industry. If market conditions discourage external equity financing, banks may have to accept slower asset growth to compensate for slower internal capital formation due to reduced profitability. This could pose a serious problem for banks trying to meet the threat of new competitors.

**Table 3.** Selected Consolidated Financial Data For All Insured Commercial Banks and Their Domestic and Foreign Subsidiaries (000's)

| | Asset Growth Rate | Total Assets | Risk[1] Assets | Total Capital | Debt[2] Capital | Equity[3] Capital | Total Capital Total Assets | Equity Capital Total Assets | Equity Capital Risk Assets |
|---|---|---|---|---|---|---|---|---|---|
| 1969 | | 554,278,810 | 389,461,702 | 45,496,931 | 2,006,665 | 43,490,266 | 8.21 | 7.85 | 11.17 |
| 1970 | 10.1 | 610,374,903 | 426,198,463 | 48,199,061 | 2,051,754 | 46,147,307 | 7.90 | 7.56 | 10.83 |
| 1971 | 13.6 | 693,557,154 | 488,374,167 | 53,014,101 | 2,968,055 | 50,046,046 | 7.64 | 7.22 | 10.25 |
| 1972 | 15.9 | 804,118,538 | 569,966,317 | 58,297,893 | 3,900,246 | 54,397,647 | 7.25 | 6.76 | 9.54 |
| 1973 | 17.4 | 943,747,439 | 682,026,819 | 65,264,542 | 4,126,241 | 61,138,301 | 6.92 | 6.49 | 8.96 |
| 1974 | 10.5 | 1,042,498,288 | 774,358,216 | 71,521,134 | 4,288,138 | 67,292,996 | 6.86 | 6.46 | 8.69 |
| 1975 | 3.3 | 1,076,519,501 | 772,433,445 | 75,968,989 | 4,191,498 | 71,777,491 | 7.06 | 6.67 | 9.29 |
| 1976 | 9.5 | 1,178,864,173 | 842,974,277 | 83,169,626 | 5,193,514 | 77,976,112 | 7.06 | 6.61 | 9.25 |
| 1977 | 13.3 | 1,335,252,358 | 961,240,072 | 91,711,126 | 5,802,141 | 85,908,985 | 6.87 | 6.43 | 8.94 |
| 1978 | 12.6 | 1,503,465,260 | 1,099,811,465 | 101,239,922 | 6,109,842 | 95,130,080 | 6.73 | 6.33 | 8.65 |
| 1979 | 12.2 | 1,686,186,770 | 1,241,846,815 | 112,303,207 | 6,206,477 | 106,096,730 | 6.66 | 6.29 | 8.54 |
| 1980 | 9.7 | 1,849,411,261 | 1,357,597,099 | 123,714,207 | 6,497,385 | 117,216,822 | 6.69 | 6.34 | 8.63 |
| 1981 | 9.3 | 2,021,855,424 | 1,523,773,268 | 135,689,525 | 6,402,149 | 129,287,376 | 6.71 | 6.39 | 8.49 |

[1]1969-75 = Total Assets − (Cash and Due From Institutions + U.S. Government & Treasury Securities + Trading Account)
1976-81 = Total Assets + Valuation Reserves − (Cash and Due From Institutions & U.S. Government + Treasury Securities + Trading Account)

[2]Includes all Subordinated Debt Regardless of Maturity. Debt Capital and Total Capital/Total Assets are therefore overstated under the new Capital Adequacy Guidelines.

[3]Includes Preferred Stock, Common Stock, Surplus, Retained Earnings and Valuation Reserves.

Source: FDIC, Consolidated Report of Condition for a Bank and its Foreign and Domestic Subsidiaries

on internal capital generation; 93.13 percent of the growth in equity capital at Georgia banks was due to internal sources.

Typically, large banks are less dependent on internal capital generation than small banks. Broad ownership and constant trading of larger banks' stock on major exchanges give them a distinct advantage in raising external capital. Many smaller banks, such as rural and community banks, have closely held ownership limiting external capital growth to only a few sources.

In the largest quartile of banks in the United States, internal capital growth was 81.41 percent of the total equity capital growth since 1970 (Table 6). Among mid-sized banks, internal growth accounted for 90.93 and 87.54 percent, respectively, for the next two quartiles. The smallest banks were the most dependent on external capital growth with the bottom quartile registering internal capital contributions of only 65.83 percent of their total equity growth since 1970. The small banks' apparently strong dependence on external capital is easily explained. Banks in this quartile are relatively new banks, which initially obtain 100 percent of their capital from external sources. In addition, new banks generally display poor earnings in their earlier years; once established, they become more dependent on internal capital growth. Internal capital growth at Sixth District banks closely parallels the pattern of all banks in the United States. The largest banks scored a 78.14 percent dependency on internal capital, while the next two quartiles showed a much stronger dependence on internal capital sources—91.36 and 88.17 percent, respectively. Just as the smallest quartile nationally displayed a weaker dependence on internal capital growth, so did the Sixth District's fourth quartile, registering 61.60 percent of total equity growth.

Bank holding company contributions of capital to subsidiary banks has proven another important element of equity growth. Approximately 78.5 percent of the nation's bank assets are controlled by bank holding companies.[1] Data indicating the extent of holding company contributions to

[1]Board of Governors of the Federal Reserve System, **1980 Annual Statistical Digest**, p. 190.

**Table 4.** Aggregate Earnings Retention Rate For All FDIC Insured Banks (percent)

| | Earnings Retention Rate |
|---|---|
| 1969 | 59.05 |
| 1970 | 57.64 |
| 1971 | 57.29 |
| 1972 | 60.93 |
| 1973 | 63.03 |
| 1974 | 60.94 |
| 1975 | 58.14 |
| 1976 | 61.38 |
| 1977 | 62.91 |
| 1978 | 65.31 |
| 1979 | 65.16 |
| 1980 | 63.44 |
| 1981 | 60.45 |
| Average | 61.85 |

Source: FDIC, Consolidated Reports of Income for a Bank and its Foreign and Domestic Subsidiaries

**Table 5.** Internal Capital Generation of U.S. Commercial Banks Expressed as a Percentage of Total Equity Growth

| | 1970–1981 Sixth District States |
|---|---|
| Alabama | 89.74 |
| Florida | 69.95 |
| Georgia | 93.13 |
| Louisiana | 85.25 |
| Mississippi | 87.21 |
| Tennessee | 79.49 |
| Total U.S. | 82.34 |

Source: FDIC, Consolidated Reports of Condition and Income for a Bank and its Foreign and Domestic Subsidiaries

**Table 6.** Internal Capital Generation By Asset Size Expressed In Quartiles* (Internal Capital Growth as a percentage of Total Equity Growth)

| | First | Second | Third | Fourth |
|---|---|---|---|---|
| U.S. Banks | 81.41 | 90.93 | 87.54 | 65.83 |
| Sixth District Banks | 78.14 | 91.36 | 88.17 | 61.60 |

*Quartiles are listed from largest banks to smallest.

Range of Average Asset Sizes Within Respective Quartiles

| | U.S. | | Sixth District | |
|---|---|---|---|---|
| | 1970 | 1981 | 1970 | 1981 |
| | (millions of $) | | (millions of $) | |
| First | 158.7 | 493.6 | 81.3 | 251.6 |
| Second | 13.1 | 39.1 | 14.9 | 44.2 |
| Third | 6.5 | 20.2 | 8.0 | 24.5 |
| Fourth | 2.8 | 8.9 | 3.5 | 11.4 |

Source: FDIC, Consolidated Reports of Condition for a Bank and its Foreign and Domestic Subsidiaries

capital accounts at subsidiary banks has been available only since 1978. Table 7 shows that bank holding companies contributed $690 million in equity to subsidiary banks in 1978, approximately 7.5 percent of total equity growth of all banks during that year. By 1981, net holding company contributions had grown to $1.462 billion and comprised 12.1 percent of equity growth during the year. Over the four-year period from 1978 to 1981, net capital contributions from bank holding companies to subsidiary banks accounted for 8.25 percent of all banks' equity capital growth. Holding company contributions may come from profits or external sources, and therefore the original source of these funds is difficult to isolate. During the same four-year period internal capital sources accounted for 86.73 percent of equity growth, leaving 5.02 percent to sources certainly external to the banking system.

Holding company capital contributions to subsidiary banks in the Sixth District (Table 7) are noticeably below the national average of 8.25 percent. Florida banks showed the most support from parent holding companies whose contributions represented 4.6 percent of that state's total equity capital growth. This is consistent with the high percentage of bank assets owned by holding companies in Florida as compared to other Sixth District states (see Table 8).

## External Capital

The role of external capital in bank equity growth has been far less significant than that of internal capital. The par value of common stock outstanding has grown by $12.9 billion since 1969 and stood at $23.4 billion at the end of 1981. Preferred stock, a much smaller component of external capital, grew only $63.5 million during

**Table 7.** Net Bank Holding Company Capital Contributions to Subsidiary Banks ($000's)

| | Ala. | Fla. | Ga. | La. | Miss. | Tenn. | Total U.S. |
|---|---|---|---|---|---|---|---|
| 1978 | 1,880 | 40,431 | 3,608 | 7,943 | 1,296 | 21,391 | 690,354 |
| 1979 | 4,557 | 25,033 | (125) | 10,813 | 0 | 3,273 | 762,502 |
| 1980 | 6,658 | 34,660 | (371) | 10,462 | 0 | 8,930 | 663,005 |
| 1981 | 2,800 | 32,136 | 5,922 | 4,868 | 7,495 | 4,743 | 1,461,561 |
| Total | 15,895 | 132,260 | 9,034 | 34,086 | 8,791 | 38,337 | 3,577,422 |
| | | | Expressed As A Percentage of Equity Growth 1978-1981 | | | | |
| | 1.3 | 4.6 | 0.6 | 2.0 | 1.2 | 2.9 | 8.25 |

Source: FDIC, Consolidated Reports of Income for a Bank and its Foreign and Domestic Subsidiaries

the same period and closed out 1981 at $167 million. When a bank sells common or preferred stock, the excess paid over the stock's par value goes to its surplus account. A bank can also transfer funds from retained earnings to surplus, leaving that account holding both internal and external sources of capital. Between 1969 and 1981, surplus grew $22.7 billion.

The third source of external capital, debt capital, has increased over twofold since 1970. Subordinated debt has grown from $2 billion at December 31, 1969 to $6.4 billion at the close of 1981. Although the total outstanding subordinated debt has increased, the percentage of subordinated debt to total equity at banks issuing subordinated debt has fallen dramatically. Debt as a percentage of total capital declined from 21.4 percent on December 31, 1969, to 13.6 percent as of year-end 1978.[2] The decreasing role of debt in bank capital composition may be due in part to regulators' stronger stance on the role of debt as capital. Also, while subordinated debt at the bank level is declining relative to bank equity, just the opposite appears to be happening in parent holding companies. A sampling of 31 of the 50 largest bank holding companies revealed that parent company long-term debt grew from 52.3 percent of consolidated long-term debt in 1970 to 78.2 percent in 1977.[3]

**Table 8.** Percentage of Commercial Bank Assets Controlled by Bank Holding Companies - by State

| | 1981P | 1978 | 1975 | 1971 |
|---|---|---|---|---|
| Alabama | 63.1 | 62.0 | 61.6 | 27.2 |
| Florida | 81.1 | 74.5 | 78.5 | 62.2 |
| Georgia | 69.0 | 58.9 | 55.6 | 56.1 |
| Louisiana | 43.4 | 32.5 | 35.9 | 30.4 |
| Mississippi | 38.2 | 30.5 | 28.8 | 26.1 |
| Tennessee | 58.3 | 54.0 | 60.5 | 47.4 |
| 50 State Total | 81.1 | 73.4 | 68.5 | 56.5 |

Source: Board of Governors of the Federal Reserve System, "Annual Statistical Digest"

P Preliminary

Despite the decline of debt as a percentage of total capital at the bank level, debt issues have significantly outpaced equity issues as a source of external capital over the past decade. Chart 1 shows the relationship of debt versus equity capital issues since 1968. For the first time in 13 years, banks' equity capital issues exceeded debt capital issues in 1981.[4] The reason is not completely clear, but tougher regulatory guidelines apparently contributed to the change. Until 1981 the trend was very clear—debt capital

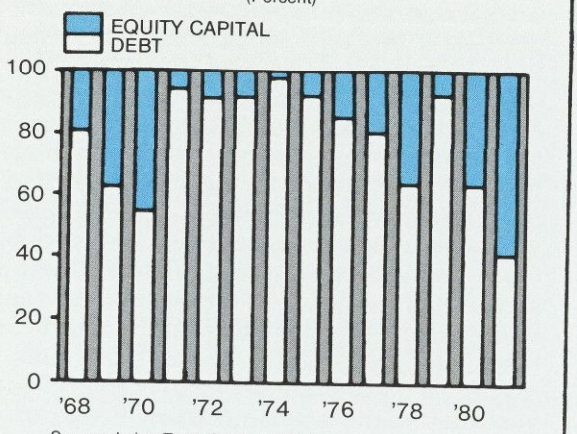
[2]Douglas V. Autin and Thomas J. Scampini, "Senior Debt Securities Revisited," **Bankers Magazine** (November-December 1980), p. 73+.

[3]Strategic Analysis Section, Office of the Comptroller of the Currency, cited in Gregory E. Boczar, "Bank Holding Company Long-Term Debt: Is It Capital?" **Issues in Bank Regulation** (Summer 1982) p. 32+.

[4]Irving Trust Company, New York.

**Chart 1.** Bank Debt vs. Equity Capital Issues

(Percent)




Source: Irving Trust Co., New York.

issues provided the majority of external capital for the banking industry.

This long term trend can be explained by three basic reasons. First, the cost of debt capital issues may be less than the actual cost for new equity. Interest expense associated with the debt is tax deductible, making the debt's after-tax expense lower than it might first appear and possibly less than the alternative cost of selling new equities. Second, a bank's market value can be less than its book value. One brokerage firm found that the average market to book value for 148 selected larger banks they followed was 72.98 percent on June 14, 1982.[5] If a bank's stock is selling below book value, management is reluctant to bring new issues to market because of the dilutive effect on present stockholders. When a bank's stock price is below book value, selling new equities can cost existing shareholders more than the average return on equity the bank earns. This dilution of ownership is obviously disturbing to stockholders. Third, in an inflationary environment investors demand higher yields through dividend payments as well as greater equity capital growth. The return on bank stocks does not meet that demand. With today's unfavorable market conditions the dilemma between investor demands for higher dividends and the need for internal equity generation is difficult to resolve. If a banking firm increases its dividend payment to stockholders it will diminish its retention rate and make the bank more dependent on external equity that may not represent a viable alternative.

What was true for banking in the 1970s may or may not be applicable to the industry during the current decade. Banking during the 70s was characterized by rapid asset growth coupled with a slower equity growth rate. The divergence of these two growth rates caused a decline of 127 basis points in the aggregate equity capital to total assets ratio, which had slipped to 6.29 percent by December 31, 1979. Most capital growth came from internal sources, indicating the industry's strong dependence on profitability and earnings retention. Of the available sources of external capital, debt was the most popular, particularly with the larger banking firms.

## Looking To The 1980s

There is little question that as the banking industry moves into the 1980s it will experience a new, more competitive operating environment. Since the Great Depression, commercial banking has experienced consistent, profitable growth. Other industry groups may have outperformed the banking industry, but none has enjoyed its stable growth.

In the next decade the industry will witness significant changes which will provide risks and rewards. Until recently, the banking system has been protected by the walls of regulation that provided three basic means of support: an exclusive product franchise, a protected geographic franchise, and limits on rates paid to savers. With the onset of bank deregulation all three areas of support have begun to crumble, and any one could have a dramatic effect on the industry.[6]

Looking back over the past decade, we see that market deregulation has led regulatory deregulation in key areas. Geographic barriers that restrict certain competition among banks are breaking down. Banks and their parent holding companies are already circumventing certain interstate restrictions and opening new markets through loan production offices (LPOs) and various nonbank subsidiaries outside their principal state of operations. Another recent development has been ATM networks which allow electronic interstate cash withdrawals.

[5] Investment Research, Goldman Sachs, (July 1982).

[6] A good discussion of the changes bank deregulation will bring to the industry can be found in George G.C. Parker, "Now Management Will Make or Break the Bank," **Harvard Business Review** (November-December 1981), p. 140+.

At the same time, banks are facing competition from new entrants into traditional banking services. The innovative entry of firms like Merrill Lynch and Sears, Roebuck into banking services is probably the most publicized example of market deregulation at work today. Through a vast network of offices, these companies are offering customers many traditional banking services and are becoming direct competitors with the industry. Also, money market mutual funds cut across geographic barriers to compete for deposits.

Market forces have led the way to interest ceiling deregulation. Inflation and the increasing cost of money during the 70s drove depositors to seek higher yields on their deposits. As depositors shifted funds from low-interest bank accounts to higher yielding investments outside the banking system, regulators were forced to relax interest limitations gradually so banks could combat the drain of deposits. Important alternative investment vehicles like six-month money market certificates and small-saver certificates are examples of the response to market deregulation. The Depository Institutions Deregulation and Monetary Control Act of 1980 began the phase-out of Regulation Q, which had imposed interest rate ceilings on savings accounts, and also ended banks' exclusive checking account franchise.

Deregulation in the 80s will bring increased competition in the financial services industry and reduced earnings for the banking industry itself. Certainly the wave of deregulation will leave some bankers disoriented—but will it also leave the industry at a competitive disadvantage?

Since commercial banks historically have depended heavily on retention of income to foster capital growth, the effects of deregulation could seriously reduce capital growth through retained earnings. A 1981 study by Irving Trust Company of New York predicts that the commercial banking industry will need almost twice as much external capital over the next five years as it did during the 1976-80 period. Irving Trust's five-year forecast projects internal generation at 75.8 percent of total capital needs requiring $20.2 billion in external capital over the 1980-85 period.[7] That is a substantially lower contribution of internal capital generation than the 82.34 percent realized over the past decade.

Banks thus may be forced to seek alternative sources of capital to supplement internal shortfalls or to cut back asset growth to parallel the slower capital growth. In some circumstances a bank really may not have a choice. Alternative sources of capital may not be available for several reasons. A new stock issue may not be practical if the bank stock is already selling at below book value. Second, the alternative of issuing debt capital may not at times be feasible. Depending on the bank's current leverage position and earnings, the price of debt as dictated by the marketplace may be so excessive as to preclude any debt offering as a viable alternative. Also, a bank can only use a certain level of debt to meet capital requirements. The Federal Reserve/OCC guidelines limit secondary capital (limited-life preferred stock and subordinated notes and debentures) to no more than 50 percent of the amount of primary capital. Equally important is the regulators' current encouragement of equity as a source of capital rather than debt.

If banks find themselves faced with these problems and decide not to accept dilution, they may be forced either to reduce dividends or to curtail asset growth to maintain a level of capital considered satisfactory by regulators (see "Finding the Equilibrium Capital Ratio").

It is unlikely that banks would cut back dividends for fear of losing investor appeal. Presently banks are paying less than the Standard and Poors composite 500 stock index of 43 percent, and any greater divergence from this level could lower investor appeal.[8]

If deregulation does hurt earnings, then curtailing asset growth may be the industry's only answer to maintaining capital requirements. That could have serious consequences on the industry's ability to compete with new entrants such as Merrill Lynch, Sears and American Express for financial services. Banks would be unable to market new services aggressively or to solicit the deposit growth necessary to compete successfully in a deregulated environment. The competitive effect would put pressure on regulators to lower capital requirements. That too could hold serious

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[7]The forecast is based on FDIC data for all insured commercial banks as of December 31, 1980 with the following assumptions:

1. Total assets (domestic and foreign) are projected to grow at the five year historical growth rate of 11 percent.
2. Return on equity is projected at the five year historical average of 14.5 percent.
3. Capital (long-term debt plus equity) as percentage of total assets is projected at the five year historical average of 6.2 percent.
4. Dividend payout is projected at 34 percent, the five year historical average.
5. Amortization of existing debt will total $2.8 billion during the next five years.

[8]**Standard and Poor's**, "Analysts Handbook 1982 Annual Edition," p. 97.

## FINDING THE EQUILIBRIUM CAPITAL RATIO

Table 9 shows the equilibrium capital ratio given varying retention and asset growth rates with a constant return on assets (ROA) of .72 percent (5 year historical average).

The equilibrium capital ratio is based on the logic that as long as you have positive profitability, there exists an equity-to-assets ratio low enough that at some point equity growth will match asset growth. To maintain a certain capital level, asset growth must equal equity growth. As equity gets smaller relative to asset size, it takes less profitability (and retention rate) to establish equal equity and asset growth rates. Therefore, given a profitable bank and no outside capital restrictions, at some level capital growth will be at equilibrium with asset growth, causing bank capital ratios to remain constant. The equilibrium capital formula used to construct the table is:

$$\text{Equilibrium Capital Ratio (\%)} = \frac{\text{Return on Assets(\%)} \times \text{Earnings Retention Rate (\%)}}{\text{Asset Growth Rate (\%)}}$$

The formula assumes that market conditions discourage external equity financing and that a bank's internal equity growth rate along with its asset growth rate determines its equity-to-assets ratio.[9]

If we use the equilibrium formula with the five-year historical average ROA of .72 percent and the five-year average retention rate of 63 percent, we find that to obtain a capital ratio of 6.5 percent (benchmark for "Zone 1" with regional banks) requires a 6.98 percent asset growth rate. This would be a significant change from the actual average asset growth rate of 11.4 percent since 1976.

Taking the same five-year historical averages and solving the equilibrium capital equation for the equilibrium capital ratio, asset and equity growth rates for the U.S. banking system would be at equilibrium when capital reached 3.97 percent of assets. Assuming that all variables remain constant, this means that the aggregate capital ratio for the banking system would decline over time from 6.39 percent at the end of 1981 to 3.97 percent.

If ROA remains near its five-year average, then, it appears that to prevent a dramatic decline in the capital ratio either asset growth must be curtailed or the retention rate increased through lower dividend payments.

[9]Roger T. Cole and Anthony G. Cornym, "Using Equilibrium Capital Ratio for Analysis," **The Magazine of Bank Administration** (February 1982), p.46+.

**Table 9.** Equilibrium Capital Ratio With A Constant ROA of .72

| | Asset Growth Rate | | | | |
|---|---|---|---|---|---|
| Retention Rate | 4 | 6 | 8 | 10 | 12 |
| 80 | 14.4 | 9.6 | 7.2 | 5.8 | 4.8 |
| 70 | 12.6 | 8.4 | 6.3 | 5.0 | 4.2 |
| 60 | 10.8 | 7.2 | 5.4 | 4.3 | 3.6 |
| 50 | 9.0 | 6.0 | 4.5 | 3.6 | 3.0 |
| 40 | 7.2 | 4.8 | 3.6 | 2.9 | 2.4 |
| 30 | 5.4 | 3.6 | 2.7 | 2.2 | 1.8 |

consequences by increasing operating risk, raising banks' cost of funds and possibly driving away uninsured depositors.

## Summary

As the banking industry enters the decade of the 1980s it faces keener competition than ever before. Deregulation of the industry is already under way, but the most profound changes are still waiting to unfold. Banking's exclusive product franchise as well as the low rates traditionally imposed on deposits are quickly eroding. In the not-to-distant future the industry's protected geographic franchise will disappear with the onset of interstate banking. All of this spells much more competition and possibly lower earnings for the industry during this decade.

Banks no longer may be able to rely on their current major source of capital generation. Retention of earnings accounted for 82.3 percent of the total equity growth in the banking system since 1970. If banks have poorer earnings in the 80s they may find it increasingly difficult to maintain capital levels that will satisfy their regulators without turning to an external capital source or perhaps restraining asset growth. Both alternatives may have serious consequences for the banking industry as deregulation progresses. New equity financing may prove dilutive to current stockholders, debt capital is encountering more stringent regulatory requirements and restrained asset growth could seriously hamper competition with new entrants into traditional banking services.

**—Robert M. Baker**

# Index for 1982

| $ millions | OCT 1982 | SEPT 1982 | OCT 1981 | ANN. % CHG. | | OCT 1982 | SEPT 1982 | OCT 1981 | ANN. % CHG. |
|---|---|---|---|---|---|---|---|---|---|
| **UNITED STATES** | | | | | | | | | |
| Commercial Bank Deposits | 1,186,862 | 1,170,355 | 1,071,259 | + 11 | Savings & Loans | | | | |
| Demand | 301,634 | 282,892 | 299,260 | + 1 | Total Deposits | 539,953 | 534,621 | 513,785 | + 5 |
| NOW | 63,411 | 59,257 | 47,846 | + 33 | NOW | 12,071 | 10,606 | 7,384 | + 63 |
| Savings | 152,861 | 149,970 | 149,437 | + 2 | Savings | 94,932 | 91,575 | 92,970 | + 2 |
| Time | 703,640 | 704,161 | 605,394 | + 16 | Time | 434,405 | 433,169 | 414,529 | + 5 |
| Credit Union Deposits | 51,237 | 48,931 | 38,960 | + 32 | | AUG | JUL | AUG | |
| Share Drafts | 3,675 | 3,153 | 2,438 | + 51 | Mortgages Outstanding | 500,610 | 501,678 | 508,932 | - 2 |
| Savings & Time | 43,372 | 41,962 | 34,424 | + 26 | Mortgage Commitments | 16,658 | 15,865 | 16,599 | + 0 |
| **SOUTHEAST** | | | | | | | | | |
| Commercial Bank Deposits | 126,387 | 124,843 | 114,351 | + 11 | Savings & Loans | | | | |
| Demand | 34,477 | 32,365 | 34,339 | + 0 | Total Deposits | 79,668 | 78,877 | 75,483 | + 6 |
| NOW | 8,193 | 7,665 | 6,017 | + 36 | NOW | 1,953 | 1,704 | 1,138 | + 72 |
| Savings | 14,969 | 14,653 | 14,718 | + 2 | Savings | 12,002 | 11,536 | 11,765 | + 2 |
| Time | 72,262 | 72,389 | 63,018 | + 15 | Time | 65,944 | 65,808 | 62,628 | + 5 |
| Credit Union Deposits | 4,846 | 4,617 | 3,704 | + 31 | | AUG | JUL | AUG | |
| Share Drafts | 348 | 302 | 264 | + 32 | Mortgages Outstanding | 69,392 | 69,737 | 74,255 | - 7 |
| Savings & Time | 4,082 | 3,896 | 3,204 | + 27 | Mortgage Commitments | 3,102 | 2,986 | 3,498 | - 11 |
| **ALABAMA** | | | | | | | | | |
| Commercial Bank Deposits | 14,004 | 13,886 | 13,112 | + 7 | Savings & Loans | | | | |
| Demand | 3,602 | 3,300 | 3,499 | + 3 | Total Deposits | 4,573 | 4,530 | 4,372 | + 5 |
| NOW | 715 | 672 | 530 | + 35 | NOW | 104 | 91 | 60 | + 73 |
| Savings | 1,585 | 1,557 | 1,556 | + 2 | Savings | 563 | 544 | 581 | - 3 |
| Time | 8,633 | 8,715 | 8,008 | + 8 | Time | 3,926 | 3,926 | 3,761 | + 4 |
| Credit Union Deposits | 851 | 837 | 570 | + 49 | | AUG | JUL | AUG | |
| Share Drafts | 68 | 59 | 53 | + 28 | Mortgages Outstanding | 3,917 | 3,957 | 4,008 | - 2 |
| Savings & Time | 707 | 677 | 510 | + 39 | Mortgage Commitments | 44 | 47 | 76 | - 42 |
| **FLORIDA** | | | | | | | | | |
| Commercial Bank Deposits | 41,217 | 40,633 | 37,589 | + 10 | Savings & Loans | | | | |
| Demand | 12,095 | 11,298 | 12,394 | - 2 | Total Deposits | 48,132 | 47,661 | 45,617 | + 6 |
| NOW | 3,568 | 3,313 | 2,613 | + 37 | NOW | 1,320 | 1,158 | 794 | + 66 |
| Savings | 6,336 | 6,176 | 6,321 | + 0 | Savings | 8,037 | 7,689 | 7,860 | + 2 |
| Time | 20,304 | 20,357 | 17,349 | + 17 | Time | 38,794 | 38,810 | 36,872 | + 5 |
| Credit Union Deposits | 2,167 | 2,083 | 1,684 | + 29 | | AUG | JUL | AUG | |
| Share Drafts | 187 | 165 | 145 | + 29 | Mortgages Outstanding | 40,891 | 41,191 | 45,272 | - 10 |
| Savings & Time | 1,686 | 1,640 | 1,321 | + 28 | Mortgage Commitments | 2,404 | 2,345 | 2,991 | - 20 |
| **GEORGIA** | | | | | | | | | |
| Commercial Bank Deposits | 17,840 | 17,374 | 15,730 | + 13 | Savings & Loans | | | | |
| Demand | 6,187 | 5,772 | 5,942 | + 4 | Total Deposits | 9,957 | 9,869 | 9,688 | + 3 |
| NOW | 1,197 | 1,101 | 882 | + 36 | NOW | 230 | 193 | 120 | + 92 |
| Savings | 1,680 | 1,637 | 1,593 | + 5 | Savings | 1,200 | 1,176 | 1,197 | + 0 |
| Time | 9,680 | 9,655 | 8,291 | + 17 | Time | 8,648 | 8,598 | 8,402 | + 3 |
| Credit Union Deposits | 897 | 855 | 711 | + 26 | | AUG | JUL | AUG | |
| Share Drafts | 36 | 29 | 21 | + 71 | Mortgages Outstanding | 8,999 | 8,996 | 9,475 | - 5 |
| Savings & Time | 803 | 775 | 673 | + 19 | Mortgage Commitments | 183 | 167 | 133 | + 38 |
| **LOUISIANA** | | | | | | | | | |
| Commercial Bank Deposits | 22,870 | 22,859 | 20,594 | + 11 | Savings & Loans | | | | |
| Demand | 5,883 | 5,758 | 5,982 | - 2 | Total Deposits | 7,978 | 7,898 | 7,330 | + 9 |
| NOW | 1,112 | 1,071 | 808 | + 38 | NOW | 124 | 110 | 69 | + 80 |
| Savings | 2,464 | 2,428 | 2,385 | + 3 | Savings | 1,263 | 1,215 | 1,194 | + 6 |
| Time | 13,961 | 13,989 | 12,064 | + 16 | Time | 6,620 | 6,591 | 6,104 | + 8 |
| Credit Union Deposits | 161 | 123 | 95 | + 69 | | AUG | JUL | AUG | |
| Share Drafts | 11 | 9 | 7 | + 57 | Mortgages Outstanding | 7,343 | 7,340 | 7,082 | + 4 |
| Savings & Time | 152 | 116 | 89 | + 71 | Mortgage Commitments | 312 | 287 | 202 | + 54 |
| **MISSISSIPPI** | | | | | | | | | |
| Commercial Bank Deposits | 10,437 | 10,375 | 9,398 | + 11 | Savings & Loans | | | | |
| Demand | 2,347 | 2,205 | 2,340 | + 0 | Total Deposits | 2,485 | 2,466 | 2,375 | + 5 |
| NOW | 591 | 571 | 444 | + 33 | NOW | 60 | 52 | 30 | +100 |
| Savings | 744 | 733 | 724 | + 3 | Savings | 236 | 232 | 234 | + 1 |
| Time | 6,991 | 6,999 | 6,207 | + 13 | Time | 2,210 | 2,197 | 2,125 | + 4 |
| Credit Union Deposits | N.A. | N.A. | N.A. | | | AUG | JUL | AUG | |
| Share Drafts | N.A. | N.A. | N.A. | | Mortgages Outstanding | 2,167 | 2,170 | 2,209 | - 2 |
| Savings & Time | N.A. | N.A. | N.A. | | Mortgage Commitments | 19 | 19 | 26 | - 27 |
| **TENNESSEE** | | | | | | | | | |
| Commercial Bank Deposits | 20,019 | 19,716 | 17,928 | + 12 | Savings & Loans | | | | |
| Demand | 4,363 | 4,032 | 4,182 | + 4 | Total Deposits | 6,543 | 6,453 | 6,101 | + 7 |
| NOW | 1,010 | 937 | 740 | + 36 | NOW | 115 | 100 | 65 | + 77 |
| Savings | 2,160 | 2,122 | 2,139 | + 1 | Savings | 703 | 680 | 699 | + 1 |
| Time | 12,693 | 12,674 | 11,099 | + 14 | Time | 5,746 | 5,686 | 5,364 | + 7 |
| Credit Union Deposits | 770 | 719 | 644 | + 20 | | AUG | JUL | AUG | |
| Share Drafts | 46 | 40 | 38 | + 21 | Mortgages Outstanding | 6,075 | 6,083 | 6,207 | - 2 |
| Savings & Time | 734 | 688 | 611 | + 20 | Mortgage Commitments | 140 | 121 | 70 | +100 |

**Notes:** All deposit data are extracted from the Federal Reserve Report of Transaction Accounts, other Deposits and Vault Cash (FR2900), and are reported for the average of the week ending the 1st Wednesday of the month. This data, reported by institutions with over $15 million in deposits as of December 31, 1979, represents 95% of deposits in the six state area. The major differences betwe this report and the "call report" are size, the treatment of interbank deposits, and the treatment of float. The data generated from the Report of Transaction Accounts is for banks over $15 million in deposits as of December 31, 1979. The total deposit data gener from the Report of Transaction Accounts eliminates interbank deposits by reporting the net of deposits "due to" and "due from" other depository institutions. The Report of Transaction Accounts subtracts cash in process of collection from demand deposits, while the report does not. 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

| | SEPT 1982 | AUG 1982 | SEPT 1981 | ANN. % CHG. | | SEPT 1982 | AUG 1982 | SEPT 1981 | ANN. % CHG. |
|---|---|---|---|---|---|---|---|---|---|
| **UNITED STATES** | | | | | | | | | |
| Civilian Labor Force - thous. | 110,546 | 111,887 | 108,273 | + 2 | Nonfarm Employment- thous. | 89,299 | 89,013 | 92,159 | - 3 |
| Total Employed - thous. | 99,851 | 101,177 | 100,389 | - 1 | Manufacturing | 18,798 | 18,724 | 20,600 | - 9 |
| Total Unemployed - thous. | 10,695 | 10,710 | 7,884 | +36 | Construction | 4,119 | 4,160 | 4,516 | - 9 |
| Unemployment Rate - % SA | 10.1 | 9.8 | 7.6 | | Trade | 20,569 | 20,560 | 20,919 | - 2 |
| Insured Unemployment - thous. | N.A. | N.A. | N.A. | | Government | 15,197 | 14,864 | 15,560 | - 2 |
| Insured Unempl. Rate - % | N.A. | N.A. | N.A. | | Services | 19,092 | 19,156 | 18,812 | + 1 |
| Mfg. Avg. Wkly. Hours | 38.6 | 39.0 | 39.4 | - 2 | Fin., Ins., & Real Est. | 5,367 | 5,415 | 5,361 | + 0 |
| Mfg. Avg. Wkly. Earn. - $ | 333 | 332 | 322 | + 3 | Trans. Com. & Pub. Util. | 5,068 | 5,034 | 5,222 | - 3 |
| **SOUTHEAST** | | | | | | | | | |
| Civilian Labor Force - thous. | 14,452 | 14,338 | 13,917 | + 4 | Nonfarm Employment- thous. | 11,330 | 11,265 | 11,473 | - 1 |
| Total Employed - thous. | 13,025 | 12,935 | 12,806 | + 2 | Manufacturing | 2,149 | 2,152 | 2,322 | - 7 |
| Total Unemployed - thous. | 1,427 | 1,403 | 1,110 | +29 | Construction | 668 | 673 | 740 | -10 |
| Unemployment Rate - % SA | 9.9 | 9.8 | 8.0 | | Trade | 2,673 | 2,672 | 2,648 | + 1 |
| Insured Unemployment - thous. | N.A. | N.A. | N.A. | | Government | 2,114 | 2,057 | 2,125 | - 1 |
| Insured Unempl. Rate - % | N.A. | N.A. | N.A. | | Services | 2,240 | 2,236 | 2,153 | + 4 |
| Mfg. Avg. Wkly. Hours | 39.2 | 39.3 | 40.1 | - 2 | Fin., Ins., & Real Est. | 637 | 641 | 633 | + 1 |
| Mfg. Avg. Wkly. Earn. - $ | 291 | 289 | 283 | + 3 | Trans. Com. & Pub. Util. | 691 | 697 | 699 | - 1 |
| **ALABAMA** | | | | | | | | | |
| Civilian Labor Force - thous. | 1,690 | 1,691 | 1,668 | + 1 | Nonfarm Employment- thous. | 1,312 | 1,319 | 1,354 | - 3 |
| Total Employed - thous. | 1,448 | 1,450 | 1,498 | - 3 | Manufacturing | 333 | 334 | 367 | - 9 |
| Total Unemployed - thous. | 241 | 241 | 170 | +42 | Construction | 63 | 63 | 66 | - 5 |
| Unemployment Rate - % SA | 14.7 | 14.2 | 10.6 | | Trade | 272 | 272 | 274 | - 1 |
| Insured Unemployment - thous. | N.A. | N.A. | N.A. | | Government | 288 | 291 | 286 | + 1 |
| Insured Unempl. Rate - % | N.A. | N.A. | N.A. | | Services | 214 | 213 | 213 | + 0 |
| Mfg. Avg. Wkly. Hours | 39.6 | 39.9 | 39.7 | - 0 | Fin., Ins., & Real Est. | 59 | 60 | 59 | 0 |
| Mfg. Avg. Wkly. Earn. - $ | 285 | 287 | 286 | - 0 | Trans. Com. & Pub. Util. | 67 | 71 | 72 | - 7 |
| **FLORIDA** | | | | | | | | | |
| Civilian Labor Force - thous. | 4,937 | 4,865 | 4,561 | + 8 | Nonfarm Employment- thous. | 3,744 | 3,702 | 3,697 | + 1 |
| Total Employed - thous. | 4,531 | 4,486 | 4,191 | + 8 | Manufacturing | 444 | 443 | 469 | - 5 |
| Total Unemployed - thous. | 406 | 379 | 369 | +10 | Construction | 253 | 254 | 290 | -13 |
| Unemployment Rate - % SA | 7.5 | 7.7 | 7.3 | | Trade | 1,009 | 1,006 | 964 | + 5 |
| Insured Unemployment - thous. | N.A. | N.A. | N.A. | | Government | 606 | 572 | 604 | + 0 |
| Insured Unempl. Rate - % | N.A. | N.A. | N.A. | | Services | 913 | 909 | 859 | + 6 |
| Mfg. Avg. Wkly. Hours | 38.8 | 38.9 | 39.9 | - 3 | Fin., Ins., & Real Est. | 277 | 278 | 273 | + 1 |
| Mfg. Avg. Wkly. Earn. - $ | 279 | 276 | 269 | + 4 | Trans. Com. & Pub. Util. | 230 | 231 | 227 | + 1 |
| **GEORGIA** | | | | | | | | | |
| Civilian Labor Force - thous. | 2,679 | 2,695 | 2,612 | + 3 | Nonfarm Employment- thous. | 2,151 | 2,149 | 2,184 | - 2 |
| Total Employed - thous. | 2,478 | 2,494 | 2,449 | + 1 | Manufacturing | 494 | 492 | 524 | - 6 |
| Total Unemployed - thous. | 201 | 201 | 163 | +23 | Construction | 98 | 100 | 102 | - 4 |
| Unemployment Rate - % SA | 7.7 | 7.4 | 6.4 | | Trade | 495 | 496 | 504 | - 2 |
| Insured Unemployment - thous. | N.A. | N.A. | N.A. | | Government | 431 | 425 | 425 | + 1 |
| Insured Unempl. Rate - % | N.A. | N.A. | N.A. | | Services | 368 | 368 | 362 | + 2 |
| Mfg. Avg. Wkly. Hours | 39.2 | 39.1 | 40.1 | - 2 | Fin., Ins., & Real Est. | 116 | 117 | 114 | + 2 |
| Mfg. Avg. Wkly. Earn. - $ | 265 | 263 | 259 | + 2 | Trans. Com. & Pub. Util. | 142 | 142 | 145 | - 2 |
| **LOUISIANA** | | | | | | | | | |
| Civilian Labor Force - thous. | 1,915 | 1,912 | 1,887 | + 1 | Nonfarm Employment- thous. | 1,613 | 1,607 | 1,649 | - 2 |
| Total Employed - thous. | 1,713 | 1,698 | 1,738 | - 1 | Manufacturing | 197 | 198 | 217 | - 9 |
| Total Unemployed - thous. | 202 | 214 | 150 | +35 | Construction | 132 | 134 | 159 | -17 |
| Unemployment Rate - % SA | 10.9 | 11.5 | 8.4 | | Trade | 370 | 370 | 367 | + 1 |
| Insured Unemployment - thous. | N.A. | N.A. | N.A. | | Government | 312 | 303 | 323 | - 3 |
| Insured Unempl. Rate - % | N.A. | N.A. | N.A. | | Services | 299 | 297 | 285 | + 5 |
| Mfg. Avg. Wkly. Hours | 39.6 | 39.5 | 41.6 | - 5 | Fin., Ins., & Real Est. | 76 | 76 | 76 | 0 |
| Mfg. Avg. Wkly. Earn. - $ | 383 | 376 | 371 | + 3 | Trans. Com. & Pub. Util. | 130 | 131 | 128 | + 2 |
| **MISSISSIPPI** | | | | | | | | | |
| Civilian Labor Force - thous. | 1,065 | 1,053 | 1,063 | + 0 | Nonfarm Employment- thous. | 796 | 783 | 826 | - 4 |
| Total Employed - thous. | 935 | 920 | 980 | - 5 | Manufacturing | 205 | 206 | 224 | - 8 |
| Total Unemployed - thous. | 130 | 132 | 83 | +57 | Construction | 40 | 40 | 43 | - 7 |
| Unemployment Rate - % SA | 13.0 | 12.7 | 8.8 | | Trade | 163 | 163 | 165 | - 1 |
| Insured Unemployment - thous. | N.A. | N.A. | N.A. | | Government | 182 | 170 | 186 | - 2 |
| Insured Unempl. Rate - % | N.A. | N.A. | N.A. | | Services | 120 | 118 | 122 | - 2 |
| Mfg. Avg. Wkly. Hours | 38.6 | 39.0 | 39.3 | - 2 | Fin., Ins., & Real Est. | 33 | 33 | 33 | 0 |
| Mfg. Avg. Wkly. Earn. - $ | 249 | 250 | 239 | + 4 | Trans. Com. & Pub. Util. | 40 | 40 | 40 | 0 |
| **TENNESSEE** | | | | | | | | | |
| Civilian Labor Force - thous. | 2,166 | 2,122 | 2,125 | + 2 | Nonfarm Employment- thous. | 1,714 | 1,705 | 1,763 | - 3 |
| Total Employed - thous. | 1,920 | 1,887 | 1,950 | - 2 | Manufacturing | 476 | 479 | 521 | - 9 |
| Total Unemployed - thous. | 247 | 236 | 175 | +41 | Construction | 82 | 82 | 80 | + 3 |
| Unemployment Rate - % SA | 11.9 | 11.2 | 8.7 | | Trade | 364 | 365 | 374 | - 3 |
| Insured Unemployment - thous. | N.A. | N.A. | N.A. | | Government | 295 | 296 | 301 | - 2 |
| Insured Unempl. Rate - % | N.A. | N.A. | N.A. | | Services | 327 | 331 | 312 | + 5 |
| Mfg. Avg. Wkly. Hours | 39.4 | 39.3 | 39.7 | - 1 | Fin., Ins., & Real Est. | 76 | 77 | 78 | - 3 |
| Mfg. Avg. Wkly. Earn. - $ | 284 | 281 | 274 | + 4 | Trans. Com. & Pub. Util. | 82 | 82 | 87 | - 6 |

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

# CONSTRUCTION

| | SEPT 1982 | AUG 1982 | SEPT 1981 | ANN % CHG | | SEPT 1982 | AUG 1982 | SEPT 1981 | ANN % CHG |
|---|---|---|---|---|---|---|---|---|---|
| **12-month Cumulative Rate** | | | | | | | | | |
| **UNITED STATES** | | | | | | | | | |
| Nonresidential Building Permits - | $ Mil. | | | | Residential Building Permits | | | | |
| Total Nonresidential | 46,253 | 47,160 | 52,666 | - 12 | Value - $ Mil. | 35,673 | 35,018 | 45,134 | - 21 |
| Industrial Bldgs. | 5,550 | 5,498 | 7,484 | - 26 | Residential Permits - Thous. | | | | |
| Offices | 12,545 | 13,392 | 14,552 | - 14 | Single-family units | 473.6 | 463.5 | 642.6 | - 26 |
| Stores | 5,382 | 5,458 | 6,482 | - 17 | Multi-family units | 403.2 | 395.1 | 459.6 | - 12 |
| Hospitals | 1,742 | 1,694 | 1,410 | - 24 | Total Building Permits | | | | |
| Schools | 794 | 861 | 767 | + 4 | Value - $ Mil. | 81,926 | 82,178 | 97,801 | - 16 |
| **SOUTHEAST** | | | | | | | | | |
| Nonresidential Building Permits - | $ Mil. | | | | Residential Building Permits | | | | |
| Total Nonresidential | 6,186 | 6,275 | 7,499 | - 18 | Value - $ Mil. | 6,482 | 6,432 | 9,363 | - 31 |
| Industrial Bldgs. | 736 | 737 | 855 | - 14 | Residential Permits - Thous. | | | | |
| Offices | 1,323 | 1,334 | 1,358 | - 3 | Single-family units | 96.4 | 93.9 | 139.5 | - 31 |
| Stores | 996 | 1,035 | 1,096 | - 9 | Multi-family units | 80.6 | 80.9 | 118.9 | - 32 |
| Hospitals | 235 | 212 | 272 | - 14 | Total Building Permits | | | | |
| Schools | 81 | 94 | 87 | - 7 | Value - $ Mil. | 12,668 | 12,707 | 16,872 | - 25 |
| **ALABAMA** | | | | | | | | | |
| Nonresidential Building Permits - | $ Mil. | | | | Residential Building Permits | | | | |
| Total Nonresidential | 402 | 387 | 429 | - 6 | Value - $ Mil. | 213 | 221 | 385 | - 45 |
| Industrial Bldgs. | 88 | 78 | 40 | +120 | Residential Permits - Thous. | | | | |
| Offices | 54 | 55 | 58 | - 7 | Single-family units | 4.0 | 3.9 | 7.1 | - 44 |
| Stores | 64 | 66 | 71 | - 10 | Multi-family units | 3.7 | 4.0 | 8.0 | - 54 |
| Hospitals | 26 | 21 | 23 | + 13 | Total Building Permits | | | | |
| Schools | 9 | 8 | 5 | + 80 | Value - $ Mil. | 615 | 607 | 815 | - 25 |
| **FLORIDA** | | | | | | | | | |
| Nonresidential Building Permits - | $ Mil. | | | | Residential Building Permits | | | | |
| Total Nonresidential | 3,068 | 3,154 | 4,288 | - 28 | Value - $ Mil. | 3,947 | 3,993 | 6,517 | - 39 |
| Industrial Bldgs. | 365 | 362 | 477 | - 23 | Residential Permits - Thous. | | | | |
| Offices | 641 | 624 | 590 | + 9 | Single-family units | 50.5 | 50.0 | 84.2 | - 40 |
| Stores | 524 | 555 | 624 | - 16 | Multi-family units | 49.5 | 50.5 | 85.0 | - 42 |
| Hospitals | 101 | 97 | 130 | - 22 | Total Building Permits | | | | |
| Schools | 17 | 18 | 22 | - 23 | Value - $ Mil. | 7,015 | 7,147 | 10,806 | - 35 |
| **GEORGIA** | | | | | | | | | |
| Nonresidential Building Permits - | $ Mil. | | | | Residential Building Permits | | | | |
| Total Nonresidential | 996 | 1,020 | 1,045 | - 5 | Value - $ Mil. | 1,168 | 1,118 | 1,138 | + 3 |
| Industrial Bldgs. | 150 | 160 | 184 | - 18 | Residential Permits - Thous. | | | | |
| Offices | 223 | 240 | 260 | - 14 | Single-family units | 22.4 | 21.4 | 23.8 | - 6 |
| Stores | 100 | 103 | 118 | - 15 | Multi-family units | 11.0 | 10.6 | 9.3 | + 18 |
| Hospitals | 23 | 26 | 23 | 0 | Total Building Permits | | | | |
| Schools | 19 | 35 | 30 | - 37 | Value - $ Mil. | 2,163 | 2,138 | 2,183 | - 1 |
| **LOUISIANA** | | | | | | | | | |
| Nonresidential Building Permits - | $ Mil. | | | | Residential Building Permits | | | | |
| Total Nonresidential | 878 | 884 | 916 | - 4 | Value - $ Mil. | 604 | 580 | 654 | - 8 |
| Industrial Bldgs. | 85 | 88 | 70 | + 21 | Residential Permits - Thous. | | | | |
| Offices | 258 | 265 | 308 | - 16 | Single-family units | 9.8 | 9.2 | 10.9 | - 10 |
| Stores | 158 | 162 | 126 | + 25 | Multi-family units | 8.1 | 8.2 | 9.1 | - 11 |
| Hospitals | 28 | 15 | 70 | - 60 | Total Building Permits | | | | |
| Schools | 25 | 25 | 21 | + 19 | Value - $ Mil. | 1,483 | 1,463 | 1,570 | - 6 |
| **MISSISSIPPI** | | | | | | | | | |
| Nonresidential Building Permits - | $ Mil. | | | | Residential Building Permits | | | | |
| Total Nonresidential | 167 | 170 | 176 | - 5 | Value - $ Mil. | 154 | 150 | 211 | - 27 |
| Industrial Bldgs. | 13 | 13 | 18 | - 28 | Residential Permits - Thous. | | | | |
| Offices | 43 | 42 | 35 | + 23 | Single-family units | 3.1 | 3.0 | 4.1 | - 24 |
| Stores | 38 | 38 | 37 | + 3 | Multi-family units | 2.1 | 2.0 | 3.0 | - 30 |
| Hospitals | 2 | 4 | 10 | - 80 | Total Building Permits | | | | |
| Schools | 1 | 1 | 1 | 0 | Value - $ Mil. | 321 | 321 | 387 | - 17 |
| **TENNESSEE** | | | | | | | | | |
| Nonresidential Building Permits - | $ Mil. | | | | Residential Building Permits | | | | |
| Total Nonresidential | 674 | 660 | 644 | + 5 | Value - $ Mil. | 395 | 371 | 457 | - 14 |
| Industrial Bldgs. | 36 | 35 | 66 | - 45 | Residential Permits - Thous. | | | | |
| Offices | 103 | 107 | 107 | - 4 | Single-family units | 6.6 | 6.3 | 9.3 | - 29 |
| Stores | 111 | 110 | 121 | - 8 | Multi-family units | 6.2 | 5.6 | 4.5 | + 38 |
| Hospitals | 46 | 40 | 16 | +188 | Total Building Permits | | | | |
| Schools | 9 | 7 | 8 | + 13 | Value - $ Mil. | 1,069 | 1,031 | 1,111 | - 4 |

**NOTES:**
Data supplied by the U. S. Bureau of the Census, Housing Units Authorized By Building Permits and Public Contracts, C-140. 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.

# GENERAL

| | LATEST DATA | CURR. PERIOD 1982 | PREV. PERIOD 1982 | YEAR AGO 1981 | ANN. % CHG. |
|---|---|---|---|---|---|
| **UNITED STATES** | | | | | |
| Personal Income ($bil. - SAAR) | 2Q | 2,541.5 | 2,518.6 | 2,370.9 | + 7 |
| Taxable Sales-$ bil. | | N.A. | N.A. | N.A. | |
| Plane Pass. Arr. 000's | | N.A. | N.A. | N.A. | |
| Petroleum Prod. (thous.) | OCT | 8657.5 | 8,684.3 | 8,618.3 | + 0 |
| Consumer Price Index 1967=100 | OCT | 294.1 | 293.3 | 279.9 | + 5 |
| Kilowatt Hours - mils. | JUN | 168.7 | 158.6 | 176.0 | - 4 |
| **SOUTHEAST** | | | | | |
| Personal Income ($bil. - SAAR) | 2Q | 301.8 | 295.3 | 280.5 | + 8 |
| Taxable Sales - $ bil. | | N.A. | N.A. | N.A. | |
| Plane Pass. Arr. 000's | AUG | 4,100.7 | 4,085.4 | 4,089.5 | + 0 |
| Petroleum Prod. (thous.) | OCT | 1,384.5 | 1,386.5 | 1,417.4 | - 2 |
| Consumer Price Index 1967=100 | | N.A. | N.A. | N.A. | |
| Kilowatt Hours - mils. | JUN | 28.9 | 24.7 | 29.0 | - 0 |
| **ALABAMA** | | | | | |
| Personal Income ($bil. - SAAR) | 2Q | 33.6 | 32.7 | 31.7 | + 6 |
| Taxable Sales - $ bil. | AUG | 21.1 | 21.1 | 20.4 | + 3 |
| Plane Pass. Arr. 000's | AUG | 107.3 | 107.8 | 111.3 | - 4 |
| Petroleum Prod. (thous.) | OCT | 54.0 | 57.0 | 60.0 | -10 |
| Consumer Price Index 1967=100 | | N.A. | N.A. | N.A. | |
| Kilowatt Hours - mils. | JUN | 3.8 | 3.4 | 4.1 | - 7 |
| **FLORIDA** | | | | | |
| Personal Income ($bil. - SAAR) | 2Q | 111.3 | 109.0 | 102.1 | + 9 |
| Taxable Sales - $ bil. | OCT | 66.6 | 66.7 | 66.1 | + 1 |
| Plane Pass. Arr. 000's | AUG | 2,019.5 | 2,009.8 | 1,889.8 | + 7 |
| Petroleum Prod. (thous.) | OCT | 72.0 | 73.0 | 95.0 | -24 |
| Consumer Price Index - Miami Nov. 1977 = 100 | | SEPT 156.1 | JUL 155.1 | SEPT 150.2 | + 4 |
| Kilowatt Hours - mils. | JUN | 8.0 | 7.0 | 8.2 | - 2 |
| **GEORGIA** | | | | | |
| Personal Income ($bil. - SAAR) | 2Q | 52.5 | 51.1 | 49.2 | + 7 |
| Taxable Sales - $ bil. | 1 | Q34.5 | 34.2 | 32.1 | + 8 |
| Plane Pass. Arr. 000's | AUG | 1,510.9 | 1,504.1 | 1,646.3 | - 8 |
| Petroleum Prod. (thous.) | OCT | N.A. | N.A. | N.A. | |
| Consumer Price Index - Atlanta 1967 = 100 | | OCT 297.8 | AUG 295.6 | OCT 281.5 | + 6 |
| Kilowatt Hours - mils. | JUN | 4.7 | 3.7 | 4.4 | + 7 |
| **LOUISIANA** | | | | | |
| Personal Income ($bil. - SAAR) | 2Q | 43.7 | 42.9 | 40.4 | + 8 |
| Taxable Sales - $ bil. | | N.A. | N.A. | N.A. | |
| Plane Pass. Arr. 000's | AUG | 272.9 | 273.5 | 272.9 | 0 |
| Petroleum Prod. (thous.) | OCT | 1,166.0 | 1,164.0 | 1,167.0 | + 0 |
| Consumer Price Index 1967 = 100 | | N.A. | N.A. | N.A. | |
| Kilowatt Hours - mils. | JUN | 5.1 | 4.3 | 4.9 | + 4 |
| **MISSISSIPPI** | | | | | |
| Personal Income ($bil. - SAAR) | 2Q | 19.7 | 19.3 | 18.5 | + 6 |
| Taxable Sales - $ bil. | | N.A. | N.A. | N.A. | |
| Plane Pass. Arr. 000's | AUG | 32.5 | 32.8 | 33.5 | - 3 |
| Petroleum Prod. (thous.) | OCT | 92.5 | 92.5 | 95.4 | - 3 |
| Consumer Price Index 1967 = 100 | | N.A. | N.A. | N.A. | |
| Kilowatt Hours - mils. | JUN | 2.0 | 1.6 | 1.9 | + 5 |
| **TENNESSEE** | | | | | |
| Personal Income ($bil. - SAAR) | 2Q | 41.0 | 40.3 | 38.6 | + 6 |
| Taxable Sales - $ bil. | OCT | 25.6 | 25.5 | 23.7 | + 8 |
| Plane Pass. Arr. 000's | AUG | 157.5 | 157.3 | 135.6 | +16 |
| Petroleum Prod. (thous.) | | N.A. | N.A. | N.A. | |
| Consumer Price Index 1967 = 100 | | N.A. | N.A. | N.A. | |
| Kilowatt Hours - mils. | JUN | 5.3 | 4.7 | 5.5 | - 4 |

| | OCT 1982 | SEPT (R) 1982 | OCT 1981 | ANN. % CHG. |
|---|---|---|---|---|
| **UNITED STATES** | | | | |
| Agriculture | | | | |
| Prices Rec'd by Farmers Index (1977=100) | 129.0 | 136.0 | 130.0 | - 1 |
| Broiler Placements (thous.) | 73,277 | 78,072 | 72,730 | + 1 |
| Calf Prices ($ per cwt.) | 59.10 | 59.10 | 59.00 | + 0 |
| Broiler Prices (¢ per lb.) | 25.1 | 27.1 | 26.0 | - 3 |
| Soybean Prices ($ per bu.) | 5.03 | 5.22 | 6.06 | -17 |
| Broiler Feed Cost ($ per ton) | 203 | 209 | 214 | - 5 |
| **SOUTHEAST** | | | | |
| Agriculture | | | | |
| Prices Rec'd by Farmers Index (1977=100) | 119.6 | 118.8 | 112.9 | + 6 |
| Broiler Placements (thous.) | 29,229 | 30,677 | 29,597 | - 1 |
| Calf Prices ($ per cwt.) | 55.25 | 55.39 | 54.28 | + 2 |
| Broiler Prices (¢ per lb.) | 24.2 | 26.6 | 24.8 | - 2 |
| Soybean Prices ($ per bu.) | 5.12 | 5.30 | 6.19 | -17 |
| Broiler Feed Cost ($ per ton) | 196 | 204 | 208 | - 6 |
| **ALABAMA** | | | | |
| Agriculture | | | | |
| Farm Cash Receipts - $ mil. (Dates: JUL, JUL) | 1,050 | - | 1,057 | - 1 |
| Broiler Placements (thous.) | 9,257 | 9,478 | 9,122 | + 1 |
| Calf Prices ($ per cwt.) | 53.40 | 56.50 | 53.80 | - 1 |
| Broiler Prices (¢ per lb.) | 24.0 | 25.0 | 24.0 | 0 |
| Soybean Prices ($ per bu.) | 5.15 | 5.33 | 6.07 | -15 |
| Broiler Feed Cost ($ per ton) | 215 | 205 | 215 | 0 |
| **FLORIDA** | | | | |
| Agriculture | | | | |
| Farm Cash Receipts - $ mil. (Dates: JUL, JUL) | 2,984 | - | 2,722 | +10 |
| Broiler Placements (thous.) | 1,702 | 1,795 | 1,861 | - 9 |
| Calf Prices ($ per cwt.) | 58.00 | 56.40 | 56.60 | + 2 |
| Broiler Prices (¢ per lb.) | 27.0 | 27.0 | 25.0 | + 8 |
| Soybean Prices ($ per bu.) | 5.15 | 5.33 | 6.07 | -15 |
| Broiler Feed Cost ($ per ton) | 205 | 210 | 220 | - 7 |
| **GEORGIA** | | | | |
| Agriculture | | | | |
| Farm Cash Receipts - $ mil. (Dates: JUL, JUL) | 1,511 | - | 1,515 | - 0 |
| Broiler Placements (thous.) | 11,412 | 12,281 | 11,502 | - 1 |
| Calf Prices ($ per cwt.) | 50.20 | 50.50 | 49.90 | + 1 |
| Broiler Prices (¢ per lb.) | 23.0 | 26.5 | 24.5 | - 6 |
| Soybean Prices ($ per bu.) | 5.05 | 5.28 | 6.15 | -18 |
| Broiler Feed Cost ($ per ton) | 184 | 200 | 200 | - 8 |
| **LOUISIANA** | | | | |
| Agriculture | | | | |
| Farm Cash Receipts - $ mil. (Dates: JUL, JUL) | 642 | - | 664 | - 3 |
| Broiler Placements (thous.) | N.A. | N.A. | N.A. | |
| Calf Prices ($ per cwt.) | 59.00 | 56.70 | 56.50 | + 4 |
| Broiler Prices (¢ per lb.) | 25.5 | 27.5 | 26.0 | - 2 |
| Soybean Prices ($ per bu.) | 5.16 | 5.30 | 6.43 | -20 |
| Broiler Feed Cost ($ per ton) | 245 | 250 | 245 | 0 |
| **MISSISSIPPI** | | | | |
| Agriculture | | | | |
| Farm Cash Receipts - $ mil. (Dates: JUL, JUL) | 976 | - | 924 | + 6 |
| Broiler Placements (thous.) | 5,640 | 5,927 | 5,249 | + 7 |
| Calf Prices ($ per cwt.) | 58.10 | 58.30 | 56.30 | + 3 |
| Broiler Prices (¢ per lb.) | 25.5 | 29.0 | 26.5 | - 4 |
| Soybean Prices ($ per bu.) | 5.11 | 5.44 | 6.22 | -18 |
| Broiler Feed Cost ($ per ton) | 180 | 200 | 200 | -10 |
| **TENNESSEE** | | | | |
| Agriculture | | | | |
| Farm Cash Receipts - $ mil. (Dates: JUL, JUL) | 822 | - | 765 | + 7 |
| Broiler Placements (thous.) | 0 | 1,217 | 1,179 | N.A. |
| Calf Prices ($ per cwt.) | 52.80 | 53.40 | 52.30 | + 1 |
| Broiler Prices (¢ per lb.) | 23.5 | 25.5 | 23.0 | + 2 |
| Soybean Prices ($ per bu.) | 5.08 | 5.09 | 5.97 | -15 |
| Broiler Feed Cost ($ per ton) | 171 | 176 | 187 | - 9 |

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

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