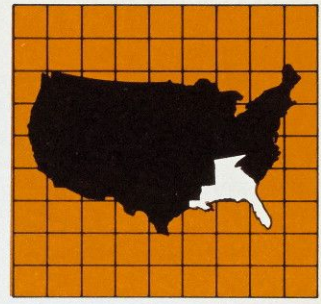


Economic Review



Federal Reserve Bank of Atlanta

July 1983

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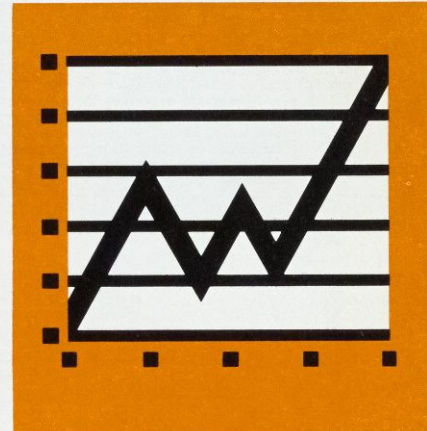
FEDERAL RESERVE BANK
OF PHILADELPHIA

SOUTHEAST Venture Capital's Role

BANKS Banks in South Perform Well

NEW POWERS S & Ls Cautious

PENSIONS Finding Most Dependent Areas



Economic Review



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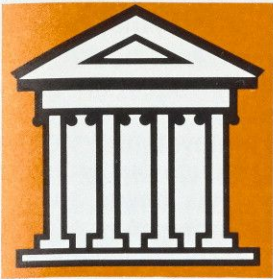
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While he is encouraged by the reawakening economy, Atlanta Fed President William F. Ford is more concerned about the nation's underlying "structural" problems. Speaking recently, Ford said several of these deepseated problems (including unrealistic expectations, the confusion of inflated values with real wealth, low levels of investment in education, and a tendency to choose conflict over cooperation) must be resolved if we are to secure a lasting recovery.

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Beyond the Current Recovery: Facing Our Structural Problems



Not even the gloomiest economist in our so-called "dismal profession" can deny that things are looking up, as we move into summer. Hammers are ringing again at homesites across the nation. Employment, which languished through our prolonged recession, has begun to grow again. Unemployment, a lagging indicator, is showing signs of improvement. And, most encouraging of all, our inflation rate remains low, for now, despite these various signs of a reawakening economy. The optimists among us hope that, if our worrisome federal deficits can be contained, we may experience a credible economic recovery free of resurgent inflation. The real question is, how long can the recovery last?

But I won't dwell on the near-term outlook. Instead, I'd like to address some basic social and structural problems facing our nation over a much longer span than just the coming months or even a year or two. These structural problems transcend even the anguish of a deep-seated national recession, as visible and painful as that has proven to be. Moreover, the issues I'll address will determine whether the **average** level of our economy's growth will be sufficient to fulfill our national aspirations over the remainder of this century.

Structural problems may not seem as immediate or as headline-grabbing as stories about today's unemployment or corporate bankruptcies. Unlike cyclical problems, our structural problems won't go away — even if we enjoy the economic upsurge and the decline in joblessness that I am forecasting for the near term. We must get our structural problems under control if we are to secure a lasting recovery that can endure for more than a few quarters, and one that won't trigger another outburst of inflation with all its attendant social tensions and problems.

Many of our so-called economic problems, according to William F. Ford, president of the Federal Reserve Bank of Atlanta, are deeply rooted in social and political issues that transcend the realm of fiscal and monetary policy. These problems, which he emphasized cannot be corrected by the government or its agencies, require instead a new kind of national resolve.

Structural Problems Won't Go Away

To get our structural problems in proper focus, it may be helpful to begin by reviewing some long-term trends that affect the way we normally interpret employment trends in our economy.

First, let me say it's not legitimate to compare the recession our country has been experiencing to the agony of the Great Depression. While it is true that far too many of our people remain

**“We must get our structural
problems under control if we
are to secure a lasting
recovery.”**

unemployed, it is important to keep the figures in perspective. Let me emphasize that I am **not** downplaying the economic hardship that many American families have suffered. It is real. Yet few of today's unemployed have experienced the kind of suffering that was commonplace in our country during the 1930s. Unfortunately for the Great Depression's jobless, they couldn't turn to the elaborate social welfare system that we maintain today. That system helps sustain many of our latest recession's unemployed men and women, about 40 percent of whom are receiving significant benefits. Many others among the unemployed have been protected from serious hardship by the widespread incidence of two and three-income families. In short, as difficult as today's problems are, they are a far cry from those bleak Depression years when President Roosevelt observed that one-third of the nation's people were ill-housed, ill-clothed and ill-fed. That's just not true today — certainly not by the “dust-bowl” standards of the 1930s.

Now, let's look critically at the unemployment numbers themselves. It is true that about 11 million of our people remain unemployed, almost as many as were jobless at the peak of unemployment in the 1930s. Thirteen million or more Americans were out of work then. Yet in those days that figure represented roughly 25 percent of the labor force, which at around 50 million was about half the size it is now. Today, those out of work represent around 10 percent of our work force of about 110 million.

Another point about unemployment that tends to be overlooked is that we have a much greater

proportion of the adult population out there looking for work today. Consider that we have created 15 million jobs in our country during the past 10 years. To be exact, between March of 1973 and this past March, we added 1.5 million jobs per year . . . 4,410 jobs per day . . . 171 jobs per hour . . . or three jobs every minute. To put these numbers in perspective, the 15 million jobs we've created since 1973 roughly equals the total number of jobs in Canada, Sweden and Switzerland combined.

How can you create that many jobs and still have growing unemployment? One answer is found in our changing labor force participation rate — the percentage of the population either working or looking for a job. It covers people ranging from teenagers up to 65-year-old seniors, and includes those listed as unemployed. That rate has gone up by more than 4 full percentage points in the past decade. Specifically, in 1982 fully 64 percent of American adults either held a job or wanted one. That's a sizable increase from the 60 percent in 1972 in that it represents over four million extra job seekers.

If you look at the actual percentage of adults in our society working in March — subtracting the unemployed job seekers — it was 56.4 percent. That actually is slightly **higher** than the 56 percent who were working in 1972. In other words, we are now seeing a larger share of America's adults working—emerging from the deepest recession since the Great Depression—than in what economists considered the strong year of 1972. That means we have kept approximately the same share of our growing adult population on the job even as unemployment went up from 5.3 percent in 1972 to today's 10.2 percent.

This, I think, reflects some basic social trends that are converging to place very strenuous demands on our economy. Over a relatively short period of time, for example, we have seen the percentage of adult women in our labor force soar from about one quarter to nearly half. They have been coming into the work force in unprecedented numbers at the same time that millions of “baby boom” teenagers have come of age while hundreds of thousands of foreigners have also poured into our country's labor pool every year. All of these groups have been hoping and expecting that our nation, the most productive in the world, can provide gainful employment for them and for everybody else who wants to work. As noted earlier, we are, in fact, absorbing a tremendous increase in our labor force by creating an impressive number of new jobs. Yet perhaps it is typical of our rising expectations that we find ourselves dissatisfied with the positive

aspects of our economy's performance in creating as many jobs as we have.

Another way of looking at our employment picture is in terms of our real standard of living. By adding 15 million jobs to our labor pool during the last 10 years, we increased the total annual hours worked by all Americans by about 16 percent. During the same period, our per capita income rose by 18 percent. Comparing those two trends, we can infer that most of the modest improvement in our standard of living over the last decade has been achieved mainly by working **harder**. This is evident in the many families in which both the husband and the wife work long hours to meet the payments on a home, the cars and appliances—material items which define “the good life” in modern society. Had we saved and invested more than we did during the 1960s and 1970s, we might have achieved more by working “smarter” rather than harder—a subject to which I'll return later.

Deficit Issue Deeper Than Budget

Now let's look at budget deficits, another long-term problem we hear a lot about. Everybody knows that our government has experienced deficits in 19 of the last 20 years. President Reagan, who is understandably worried about setting new records for deficit spending, didn't plan to rewrite the record books in that area. He has tried to fight burgeoning deficits as vigorously as he can. Still, virtually everyone who studies the projections agrees that we are going to accumulate a deficit of about \$200 billion in this fiscal year. In fact, with two-thirds of the fiscal year completed, the deficit had already mounted to \$162 billion at the end of May.

I won't repeat the oft-cited horror stories about the dangers such large deficits pose — although I believe that many of the fears are well-founded. Yet I submit that the deficit issue goes deeper — much deeper — than just the budgeting problems we normally talk about. By now, it is apparent to everyone that we should get our fiscal house in order. Unlike most commentators, I don't even blame Congress for our budget problems. Why? Because I think we really do have a legitimate democracy in this country, a democracy in which our Congress truly reflects the will of the American people and **their** expectations. Instead of simply chiding Congress, I believe that we must reassess the expectations of our voting

population that lie behind the actions of our elected representatives.

What have the American people come to expect from the government? And what are they getting? Well, it appears that a lot of Americans think we can have more guns and more butter, more defense and more social welfare spending — all at once. Many Americans also seem to believe that we can enjoy all of these things and reduce taxes at the same time! I submit that those combined expectations defy common sense — they just don't add up. There is no way Americans can have much more defense... and more social spending... while simultaneously lowering taxes sharply. We are simply expecting more of our economic system than it is capable of producing under current conditions. Our huge budget deficits are a symptom of this—as fever is a symptom of an underlying ailment.

Over the past few years, the percentage of our Gross National Product consumed by federal spending has swollen ominously. Ten years ago, the government consumed only 20.6 percent of GNP. By 1979, that share had inched up to 21.1 percent. But in the past three years it has risen to 25 percent (1982). It continues to rise today, setting new records day by day as the deficit grows bigger and bigger. Of even greater concern is the likelihood that huge deficits will persist

“There is no way Americans can have much more defense—and more social spending—while simultaneously lowering taxes sharply.”

long after the recession. The administration now projects a \$190.2 billion deficit for fiscal 1984 and \$184.6 for fiscal 1985. Those are years when unemployment presumably will have declined, reducing the drain on government revenues. Yet the prospect of gigantic deficits remains.

Moreover, the Federal Reserve certainly cannot solve the basic lack of logic in our “expectations equation.” As powerful as the Fed surely is, it can

do nothing to deal with such fundamental illogic in the American political system and the expectations of our people. As our Chairman Paul Volcker has often noted, there is no way that we can fight inflation successfully and act to maintain low interest rates when federal spending outruns tax collections by such huge margins.

A lot of us are worried that the government's appetite for credit tends to crowd out private borrowers — especially during periods when the private sector is expanding. America's industry must be able to secure credit on reasonable terms if it is to modernize and extend our productive facilities, regain international competitiveness and create even more new jobs. Instead, our recession-battered private sector — the real source of our nation's wealth and productivity — has shrunk even while the government has burgeoned. This is a disaster for any country predicated on free enterprise. And it of course helps to explain why so many American households must put in a total of well over 100 hours work per week—with two or more workers contributing—just to keep their heads above water financially. We must find a way to reduce the federal share of this country's economic pie because bureaucrats don't generate much of our nation's wealth. They just redistribute it and, in the process, they inevitably waste part of it.

Inflated Values Are Not Real Wealth

Another classic mistake that we have been making in our country recently involves confusing inflated values of old assets with additions to our real wealth. Adam Smith, who got our economics profession rolling back in 1776, published an interesting book on that subject entitled **The Wealth of Nations**. Contrary to the thinking of the pro-government mercantilists who opposed him, Smith argued that the real wealth of a nation does not consist of the size of its gold pile or its hoards of other precious things. In those days, everyone was trying to beggar his neighbor with protectionist policies — ominous echoes of which can be seen and heard in our public debates today. The bigger your gold pile, so the mercantilist reasoning went, the richer you were. Everyone tried to promote his or her exports, while curtailing imports from others, to realize a trade surplus redeemable in gold or other "hard assets." Unfortunately, because exports **must** equal imports

on a global basis, such policies just end up reducing the overall volume of trade and the economic benefits of specialization that flow from it.

Recently, I've seen alarming evidence that we are beginning to give serious consideration to self-defeating protectionist policies like that again. The time has come to reaffirm that a nation's real wealth clearly is **not** in its hoard of gold coins, old carpets, foreign exchange hoards and so on. Every year, in South Africa, Russia, South Dakota and elsewhere—tens of thousands of gold miners laboriously dig up mountains of dirt to extract less than one ounce of gold per ton of dirt. Many of them are injured and die in the process. Then we mint it into coins and bars and ship it all over the world where we rebury it in a bank vault or safe deposit box. Can you see the irony in all this? No, the number of gold coins we all have buried in some bank's vaults isn't the measure of our wealth.

Nor can your real wealth be measured by the changing value of your home. Neither you nor the nation truly grows wealthier just because inflation pushes up the paper value of our existing homes, coins, rugs and stamps. The truth is that many of our aging homes, for example, need new roofs, new paint jobs and other repairs just to keep their real value from **falling**. Yet our realtors encourage us to believe that our "net worth" is rising as our homes are artificially inflated in market value while they actually deteriorate physically. Have you ever noticed that, if you stay in the same house as its "market value" inflates, the most noticeable result is that your property taxes and fire insurance bills rise? And that, if and when you move, the supposedly marvelous gain in the value of your old home seems to evaporate when you shop for a comparable home in another city?

No, as Adam Smith told us over 200 years ago, the real wealth of a nation lies in the productivity of its people and its factories and its shops. Its wealth lies in its ability to produce **new** things that are valuable to us as consumers — activities that can raise our real standard of living and that of our countrymen. We have lost sight of that overriding objective because we have focused, shortsightedly, on our inflated old assets and their artificially increased values. I say we have focused much too intently on our Oriental rugs, our gold coins, our old houses and our vintage sport cars. We pay too little attention to building up our stock of new goods and equipment. Most

importantly, we pay too little attention to our stock of young people and their ability and will to work at the jobs that are essential to operating our nation's plants and offices of today—and tomorrow. We have paid so little attention to these really important things that our nation may be losing the vitality that we must have to prepare for the next century.

Education Mismatched with Job Skills

In Atlanta, our Chamber of Commerce recently prepared a white paper on the city's needs for skilled workers over the next 20 years. That study dramatized the mismatch between the jobs most likely to be created in the future and the skills of students currently graduating from our schools. You don't have to read our white paper to guess the results. Many of the jobs that will be created in the Atlanta area are going to be in high-technology activities, in information processing, in the hospitality industry and in health and skilled trades. Many will be in communications, computers and other components of our emerging "information industry." Yet what percentage of the young people in our school systems have a computer in front of them today? The answer is — a very small fraction. Every year we graduate students who have never seen a computer, students who are not prepared for even yesterday's low-skill jobs, much less the high-skill, high-technology careers of the future.

Yet Atlanta probably comes out ahead of the nation in that regard. The Atlanta Fed is working intensely with our commercial bankers and the public school system to train students on up-to-date banking systems, qualifying them for careers in financial services. We graduated nearly 60 students from Atlanta's Harper High Magnet School last month and we plan to train more next year. Yet those numbers pale by comparison with the magnitude of the total problem we face in preparing thousands of our inner city youths for the jobs of tomorrow.

We must invest the money and know-how to correct this mismatch in available jobs and graduates' skills. We must come up with a match to train the younger people coming into the labor force to handle a new generation of jobs. And we must retrain millions of adults now being displaced from the blue-collar jobs that are fast disappearing as labor-intensive industries migrate toward the areas of the world where labor is cheaper and more plentiful.

National Over-Consumption

What about our other structural problems? Over-consumption qualifies as one. As a nation, we are consuming much more than we can afford if we hope to prepare for the future. We now spend 16 times as much as we save — of

“We must invest the money and know-how to correct the mismatch in available jobs and graduates' skills.”

every dollar, we spend about 94 cents and save only six. No nation in the world has long increased its real standard of living with such a high rate of consumption and such a low level of saving. Our personal savings rate is the lowest among major Western nations — and by a large margin. I blame both our craving for consumption and the fact that we have allowed inflation to pick the saver's pocket. The results of such trends were clearly predictable years ago. Because we have been generating consistently poor savings and investment rates, we have also found ourselves saddled with the lowest productivity gains among the industrial nations over the past five to ten years. This again helps to explain why so many American families have to work so hard, nowadays, just to maintain their real standard of living in the face of inflation. Low savings and slow gains in productivity go together like a hand in a glove. Obviously we must break that pattern, too, if we want to achieve sustained non-inflationary growth.

How can we address this problem? For starters, we must not allow our tax system to subsidize spendthrifts, nor to penalize productive investment. Consider that you can deduct interest from your taxes when you borrow money, or when you buy something to consume on credit. Yet if you save and earn interest on savings, you normally can't deduct that from your tax bill. In fact, you pay taxes on interest income! Such tax laws clearly encourage consumption and discourage saving. Our tax mix must be sharply revised so that we do much more to encourage investment and savings and much less to subsidize excessive consumption. Whether we find the answer in the approaches that have inspired economic success in other nations or we tackle the problem through our own innovation, we

have to reassess such factors as our long-term consumption and investment patterns if we want to solve our structural problems.

An Adversarial Society

Proceeding down toward the bottom line, I want to review another major issue that has little to do with economics. But it has a lot to do with the way different elements in our society work together — or, I should say, fail to work together. I'm concerned that our society has become overly contentious. Our companies, our workers and our government have established and institutionalized adversarial relationships that have proved to be self-destructive in the international trade arena—in fact, in many arenas.

We can measure this polarization in many ways. One way is to look at it in terms of professional development. Did you know that in the United States we count 2,400 lawyers for every million Americans? In the United Kingdom, which also has a lot of lawyers, they number about 900 per million—only three-eighths of our level. West Germany, which generates a much

“Our companies, our workers, and our government have established adversarial relationships that have proven to be self-destructive.”

higher savings rate and a better economic performance than we do, has about 500 lawyers per million, about one fifth as many as we have. In Japan, the number is just 100 lawyers per million. In other words, we have 24 times as many lawyers per capita as they do in Japan. Did you know there are far more lawyers just on Manhattan Island than in all of Japan? Are we encouraging too many of our brightest young people, our highest achievers, to enter law school so they can help us sue each other? I'm not suggesting that lawyers are responsible for either our quarrelsomeness or our economic problems; but I am suggesting that they may be reflecting unhealthy trends in a society that is too busy squabbling internally to compete more effectively in the world marketplace.

Looking at another way we allocate our human resources, we should also note that the Japanese

graduated 87,000 engineers from their schools in 1981. We produced just 63,000 engineers during that year. In other words, a nation with about half our population trained 38 percent more engineers than we did in 1981! Does that make sense to you?

Further comparisons with the Japanese might help to illustrate my point. Did you know that, over the last year, the Japanese sold us about 250,000 cars per month, on average? Do you know how many we sold them? About 250 per month! Of course we are complaining that their import policies are too restrictive, that they erect all sorts of not-so-subtle barriers to keep our manufacturers from competing on an equal footing. That may offer us some consolation, but it doesn't provide a completely satisfactory answer for me. I am left with many troubling questions. Must Japanese cars outsell ours, in our respective export markets, by 1,000 to one? Could we do better than that by training more engineers and fewer lawyers, perhaps? Think about it.

Let me expand on my premise that we have become overly contentious. I would argue that we have structured our society, both legally and constitutionally, so that we virtually guarantee conflict. One example of that is called “collective bargaining.” Now, I am not anti-union, and I definitely don't want to destroy organized labor. I am talking about a social concept that transcends unions and management. Our “us-against-them” approach to labor relations clearly is out of line with that of such nations as Japan. That nation's success has been based on a partnership fashioned not only between industry and labor, but including government as well. Their partnership, which we have labeled “Japan Inc.,” has contributed greatly to the resurgence of a nation that came out of World War II — just 37 years ago — absolutely devastated.

The major elements of Japanese society work together against external competition. But we seem to be engaged in self-destructive economic civil war — waged, as often as not, before television cameras — with high-priced attorneys and bureaucrats on both sides. In Japan, on the other hand, management shows much greater concern over the security and welfare of workers, while the workers produce more. Why can't we do more of this?

Many of our conflicts are magnified, of course, in recessionary periods, when contending groups in our society fight for their share of a shrinking economic pie. We have seen that recently as

more of our industries have clamored for protection and favorable legislation. Instead of engaging in legislative one-upsmanship, we should be working together more effectively to enlarge our economic pie. Perhaps we should all be cooperating as they do at progressive American companies such as Atlanta's Delta Air Lines — where the workers recently pitched in to buy their company a new jet airplane worth over \$30 million. The workers presented it to their company last December with a big red velvet ribbon around it. It was named "The Spirit of Delta" — reminiscent of Charles Lindbergh's "Spirit of St. Louis."

Far too often, many of our companies seem to be torn apart by conflicts that decrease production — conflicts with their own workers and their own government. All that clearly impairs their ability to use scarce resources to expand their productivity effectively. Wouldn't it be better if our government, our workers, and management could learn to meet each others' needs through cooperation rather than conflict? Think about it.

That brings me to another dimension of contentiousness in our society — the unseemly ongoing battle between consumers and businesses in America. Of course there have been cases in which American businesses have tried to exploit consumers. It would be naive to suggest otherwise. It is less often noted, but also important that a small minority of consumers also exploit the businesses that serve them, in various ways. Shoplifting, which bleeds merchants of an estimated \$16 billion each year, is only the most obvious form of this. One also wonders how many consumers purposely take advantage of liberal exchange policies by returning damaged items that were actually received in good condition? Yet these destructive patterns of behavior shouldn't cause us to perpetuate a continuing intramural conflict between these two elements of our society that obviously need each other urgently. In the end, we all bear the costs of such contentious and selfish behavior. Hasn't the time come to find a way to stop it?

Why do we have this kind of conflict between consumers and manufacturers? Between workers and labor? Between corporations and the government? Between the old and the young? Between blacks and whites? Between males and females in our society? Even between millions of individuals, whose personal disputes have snarled our courts in a national morass of lawsuits and

countersuits? Why do we take our petty grievances to court instead of solving our problems amicably through cooperation? Why don't we rely on compromise rather than such costly conflicts as strikes and lawsuits involving billions of dollars worth of wasted resources, and billions of hours of wasted work?

I mentioned the conflict between young and old, a very real element in our society. We've all witnessed that conflict between young Americans and their parents. Too often, social workers tell us, American children turn their backs on their elders as a nuisance and a burden. They soothe their consciences with the knowledge that their aging parents will be sustained by a Social Security check — while living in an impersonal residence for the aged which the old people derisively call "vegetable farms."

Social Security, of course, has proven to be a problem in itself. The system's financial problems commanded the recent attention of the Reagan administration through its National Commission on Social Security Reform headed by Alan Greenspan. The commission's proposals, which won the support of Congress and the

"We must stop squandering
our energies on destructive
infighting."

President, called for a combination of measures to stave off a threatened crisis in the program. Yet an even deeper, more personal problem is that so many parents feel that they are being turned out by their children — even when they do receive their Social Security checks. They feel rejected because they believe nobody really cares about them, **personally**, not even their own families. If you doubt this, spend a few hours talking with old people—as I have—and listen. You will be amazed at the depth of the resentment many of them feel—toward their own children.

Love in Short Supply

Sometimes it appears that love is in pretty short supply in America — paradoxically, I would

say, in a nation that devotes a disproportionate amount of resources to television shows, movies and magazines on the subject. As a nation, we don't even seem to be able and willing to live together nowadays. The last census revealed that more than 18 million American "households" were composed of a single person. The census takers didn't ask these people how they felt about it. I'm sure that, if they had, they would have found a lot of lonely people, old and young, out there — wishing they could find a decent way to live with others who would care about them, personally.

We are driving each other out of our homes, judging from our appalling divorce rate and the alienation between our young people and their elders. And when children run away from home, when fathers desert their wives and children, when aging parents are forced to live alone, social welfare programs of course are expected to solve the hardships that result. When you get to the bottom of it, though, is the burgeoning budget for our social welfare programs the real solution? Or do the deficits that such programs generate simply reflect more basic problems in the way our institutions — such as the family and the corporation — operate?

Yet some people like to pretend that these are economic problems that Paul Volcker, William Ford and the other 17 men and women who serve on the Federal Open Market Committee can solve by manipulating monetary variables. I want to suggest that no small group of public policymakers can possibly solve these basic issues facing our nation. Our so-called "economic troubles," I think, are deeply rooted in social and political problems that transcend the realm of fiscal and monetary policy. These social — and I daresay spiritual — problems are our nation's basic affliction. The deficits, the high interest rates, and all the other economic problems we talk about so much are largely symptoms. These problems will require corrective actions on a

level that transcends the mundane and very limited powers of the FOMC, the OMB, or even Congress and our President.

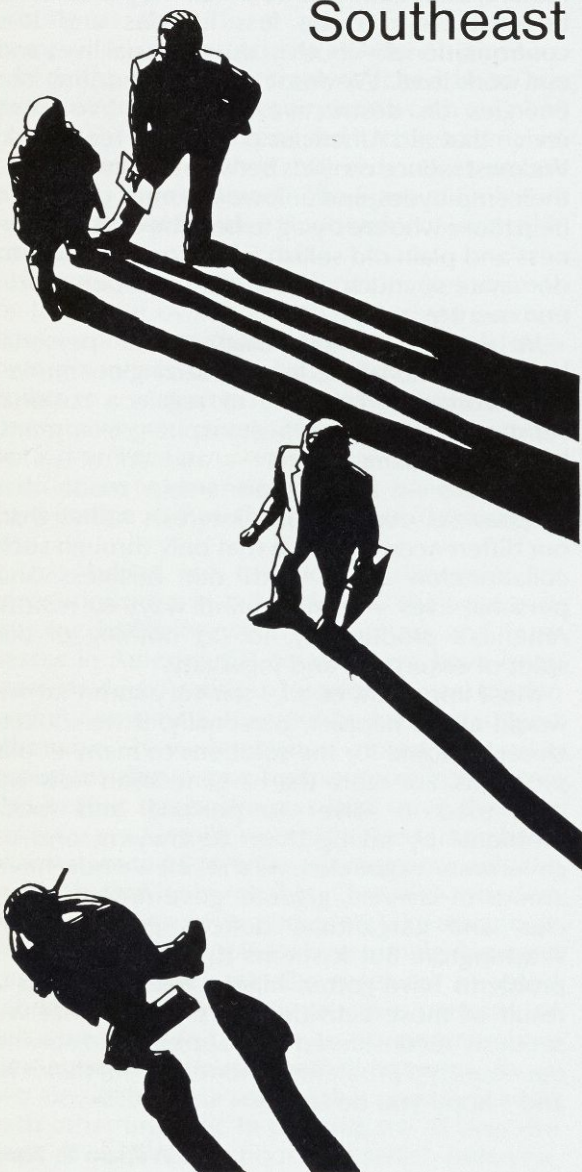
Instead, they cry out for a new kind of national resolve. They call for a dedication by each of us to seek ways to be less litigious and less confrontational — both in our personal lives and our work lives. We must stop squandering our energies on destructive infighting. We must revive that old American concept of teamwork. We must reduce conflicts between our companies, their employees, and unions. We must pitch in to help those who are trying to heal the contentiousness and plain old selfish behavior that seem to dominate so much of what we see around us in our country today.

In short, we must channel our personal leadership and talents into mobilizing our human and economic resources to regain a national sense of purpose. We must inspire government, labor and management — and all of us as individuals — into a partnership mode that emphasizes our common interests rather than our differences. I believe that only through such collaboration — in both our business and personal lives — can we find ways to restore America's productivity, to say nothing of our spirit of enterprise and ingenuity.

Most important of all, I am very sure that we would all be happier, personally, if we looked closer to home for the solutions to many of our problems. For more than a generation now we have tried to solve our personal and social problems by taking them to lawyers, and to government agencies. As a result we now have armies of lawyers, gigantic government agencies, and gargantuan deficits generated in Washington. But it seems to me that our real problems have gotten bigger, not smaller, as a result of those activities. Isn't it time that we seriously reconsidered that approach to solving our country's problems? I honestly feel that it is, and I hope you do too.

—William F. Ford

Venture Capital and Economic Growth in the Southeast



Will difficulty in obtaining capital choke off the growth of dynamic young companies that generate most of the nation's new jobs? Here's a look at the venture capital firms and government entities that step in to take business risks that conventional investors shun.

American industry is in the midst of profound changes. Heavy foreign competition in many traditional industries, such as textiles, steel and autos, as well as rapid technological change in office and factory automation, have shifted industry employment patterns dramatically. One effect of these changes has been intensified competition among states and among urban areas to attract plants in the industries expected to grow in the near future. These growing sectors often are identified, rightly or wrongly, with high-technology industry. Courting high-tech firms has replaced "smokestack chasing" in most states' approach toward industrial development.

Nonetheless, for several reasons high-tech employment alone seems unlikely to fulfill most states' need for employment growth and economic development. First and foremost, there simply is too little of it to go around. According to some forecasters, high-tech industry is expected to add only one million or fewer new jobs in the next decade, far fewer than the number lost in recent years in other manufacturing sectors. The promise of technology lies more in increasing the productivity of other industries and thus raising living standards.

Many areas will be unable to lure technology-based enterprises because these industries are relatively concentrated. Much of the employment is located in relatively few states—principally Massachusetts, New York, Florida, Texas, Illinois and California. High-technology firms engage in a large amount of research and development and use relatively new, state-of-the-art techniques and processes. By their nature, they require the diverse resource base of other industries, research universities and technical and professional personnel available in the states mentioned. Much of what passes for high-tech employment outside the major centers is mainly production employment rather than what could be construed strictly as high technology.

Another reason high tech holds little growth potential for many areas is that most job growth is being produced not by large existing firms but by small new enterprises. David Birch studied the employment patterns of U. S. business establishments and found that small firms with 20 or fewer employees created 66 percent of all new jobs, and single-establishment firms accounted for 52 percent.¹ Two-thirds of the new jobs are created by firms less than five years old (young firms have a high death rate too, but the

¹David Birch, *The Job Generation Process*, MIT, 1979.

excess of births over deaths is substantial). Many development planners are concluding that it is wrong to focus only on large firms considering branch plant locations; most job creation is home-grown. Politically, the large relocation may look attractive, but the real potential lies with smaller firms.

Fostering the growth of small young enterprises and the birth of others has confounded policy-makers in recent years. What can city and state governments do to promote economic growth from this source? Two kinds of suggestions have been put forth so far: first, improve the economic environment by reducing the state and local tax burden and reducing the regulatory requirements on small business and, second, provide resources that are in short supply for small firms, principally trained labor and capital. The former approach, especially tax policy by states, has been much discussed, but many feel that changes in tax rates would do little to help the growth of most areas. Studies of business location decisions and the birth of new firms generally show that differing tax rates between alternative locations have no measurable effect on these decisions. Recent studies by the authors indicate that environmental regulation is also a minor factor in most location decisions.²

It is in the second policy area, making resources available to small business, that attention is increasingly focused. Job-training programs, either of a general nature or directed towards the needs of a particular firm, have become widespread. For the most part, however, these programs involve relatively few workers and therefore have a limited impact.

The other resource small businesses need is capital, both for start-up and for expansion. David Birch's work demonstrated that all regions of the country have about the same business death rate, indicating that the more rapidly growing areas grew mainly as a result of dramatically higher birth rates. Providing capital for promising new enterprises is an effective way to stimulate the local economy. In addition, capital markets seem reluctant to provide start-up financing for entrepreneurs who have no assets to back up a loan except their ideas, inventions or business ability. Lack of capital is seen as a barrier to the emergence of new business, which produces most of the net growth of jobs. As a

²John Hekman, Mike Miles, Roger Pratt, "Impact of Environmental Regulation on Industrial Development in North Carolina." Center for Urban and Regional Studies, 1981.

result, there is increasing interest in private sector sources of venture capital, in providing public funds to promote economic development directly by providing equity financing for new business, and in supporting the development of new venture capital sources, often through a public-private partnership.

Where Venture Capital Is Used

The U. S. venture capital industry provides financing to young firms for three principal purposes, generally described as "early stage," "expansion" and "acquisition or management buyout." Together they comprise a portion of the capital market not fully served by the traditional sources, the stock and bond markets and commercial banks. Early stage activities are of two kinds: seed financing, which supplies a small amount of capital for an individual entrepreneur to prove a concept or develop a new product; and start-up financing, provided to a company to begin developing and marketing an established product.

Most early stage financing comes from "informal investors"—individuals of means, most often friends or relatives of the firm's founder. Informal investors may represent the largest single source of venture capital in the country, although the actual extent of their investments is unknown. Professional venture capital firms are less interested in small-scale investments in start-ups, because the risks are quite high and the amount of oversight and management per dollar invested are too great. As a result, most early stage financing goes the informal route.

Venture capital firms prefer the next level of investment, expansion financing. This is divided into stages according to the level of development reached by a new business. The first and second stages refer to the initial marketing of a product, when working capital is needed. Third-stage financing is for a major expansion when a business already shows promise and is generating some cash flow and possibly making a profit. Fourth-stage financing is for a company expecting to go public within six months or a year. It can also involve restructuring the positions of major stockholders through secondary transactions, if early investors want to reduce or liquidate their positions. Venture capitalists participating in such financing seek profits from an equity (and/or debt) position that typically is liquidated in a subsequent public offering.

Venture capital also is used for acquisition or management buyout of a business at any stage of

Table 1. The Venture Capital Pool, 1981

Type of Firm	Investments (Billions)	Percent of Total
Independent	\$2.320	40
SBIC	1.798	31
Corporate	1.682	29
	5.800	100

Source: "Special Report—Venture Capital Disbursements 1981: A Statistical Overview," *Venture Capital Journal*, June 1982.

development. Many buyouts involve the acquisition of a closely-held or family-owned business. The purpose often is to revitalize a stagnant or slow-growing operation. This use of venture capital holds less potential for producing dramatic growth in a business, and therefore it is undertaken mainly by private venture capital firms, while public agencies are more concerned with funding new businesses.

Private Sources of Venture Capital

The three major types of private sector venture capitalists are the independent firms (mainly venture capital partnerships), the government-fostered Small Business Investment Companies (SBICs) and the corporate subsidiaries. Table 1 presents the size of these three sectors in 1981 in relation to the total pool of privately-invested venture capital.

The independent firms number about 250 at present, although only 100 or so are very active. The first of the modern type was American Research and Development (ARD), established in Boston in 1946. ARD created the image of tremendous growth potential by its success with a small investment in Digital Equipment Corporation when DEC was just getting off the ground. Before ARD, most venture capital came from wealthy families such as the Rockefellers and the Whitneys. Today these have been succeeded largely by partnerships and corporations funded by pensions, insurance companies, endowments, foundations and bank trust departments as well as wealthy individuals. The ten largest firms, located in New York, Chicago and California, have between \$50 million and \$100 million of paid-in capital. Representing about 40 percent of the venture capital pool, the independents typically make equity investments of from \$250,000 to \$1 million in five to ten projects a year.

SBICs were the second important component of the new venture capital industry to arrive on the scene, following the Small Business Investment Act of 1958. As vehicles for small business financing, SBICs enjoy certain tax advantages as well as the ability to borrow from the government to provide attractive financial leverage. An SBIC is a private company owned by investors who contribute at least \$150,000 in equity capital. This makes it eligible to borrow up to three times the amount of its capital from the Small Business Administration; if the SBIC has over \$500,000 of capital, it can borrow up to four times its equity. The SBIC program has created millions of jobs and has been called an ideal combination of public policy and private enterprise, despite early problems.

Between 1960 and 1962 some 585 SBICs were licensed, leading to shakeout. Many firms suffered from inadequate capitalization, inexperience with government regulation and general lack of ability to deal with risky ventures. However, the SBICs (along with other venture capital firms) rebounded strongly in the late 1970s. Today there are about 340, of which about half make equity investments and half make loans. These firms represent about 31 percent of the venture capital pool and typically make about five to ten investments per year in the neighborhood of \$100,000 to \$1 million.

The MESBIC (Minority Enterprise SBIC), now referred to as the Section 301(d) SBIC, is similar to the SBIC. About 120 such firms provide financing for small businesses that are at least 51 percent owned by socially or economically disadvantaged persons. They are eligible for SBA purchases of their 3 percent preferred stock and a subsidized rate on their debentures in the first five years. They also may be organized on a non-profit basis to obtain additional tax benefits for themselves and their investors. This part of the venture capital industry has grown slowly, largely because it has not been very successful in raising capital. As of mid-1980, the 120 firms had raised only \$84 million.

Corporate venture capital firms are mainly subsidiaries of large companies such as Exxon and General Electric. Most have started since the late 1970s, when corporate liquidity was high, to invest in the new products and technologies that frequently come from new firms. Clearly, some corporations have found it difficult to combine the large corporate structure with a risk-taking venture capital subsidiary. Problems often arise if the subsidiary is managed by corporate personnel

who are not venture capital professionals, if corporate goals do not match those of the subsidiary and if the corporation is not patient enough to allow for the long development period of many of the young firms in which it has invested.

Today most corporate venture capital firms are subsidiaries of large financial institutions or industrial corporations. About 50 are making investments today, comprising 29 percent of the venture capital pool. They range in size from \$5 million to \$100 million and commit about \$1 million to \$5 million to each project, although individual investments have ranged as high as \$15 million. An investment often aims toward a possible acquisition as well as earning capital gains.

The Growth of Venture Capital

Venture capital investments have expanded rapidly in recent years, from just over \$300 million in 1979 to \$1.3 billion in 1981. The accumulated pool of funds has about doubled in the same period. Three reasons often cited for this growth are the reduced capital gains tax rate since 1978, the interest in emerging technologies and the entry of large pension funds into the market. The capital gains tax reduction helped spur a 300 percent increase in investments between 1978 and 1979 alone.

Does such growth pose a danger of too much capital chasing too few opportunities? Competition among investors has increased, increasing investor prices (measured as a multiple of earnings). It has also encouraged venture capitalists to look toward start-ups in addition to traditional expansion financing, and this increases risk substantially. Some believe that an increased supply of capital relative to the number of qualified entrepreneurs may hurt the risk-adjusted return performance of venture capital funds in the coming years; however, such a trend is not yet evident.

Increased participation by large pension funds has fueled the growth of venture capital. Pension funds were responsible for about 37 percent of the funds committed to the industry in 1981. They have been attracted by the high expected rates of return, by the poor performance of the stock market and, most recently, by the lower returns earned on real estate investments. However, even with the large increase in venture capital investments, the pension funds have committed less than one percent of their total assets (currently over \$800 billion) to this area,

so they represent the largest potential pool of venture capital for the future.

The other major reason for venture capital growth is the upsurge of interest in technology-related ventures. Venture capital firms favor high-technology investments almost to the exclusion of other types, judging from the pattern of recent investments and the firms' preference in the ventures they are willing to consider. According to Stanley Pratt, editor of the **Venture Capital Journal**:

applications of technology innovation continued to be the main focus of professional venture capitalists last year. Combined investment in the computer, communications, other electronics-related industries and industrial automation accounts for more than 60 percent of the total number of recorded investments in 1981. In addition, technology-related aspects of genetic engineering and medical equipment bring the total to more than two-thirds of industry activity.³

When energy-related projects are included, the total rises to 80 percent of the investments and 87 percent of the dollars invested. Table 2 presents the percent distribution of venture capital investments by industry for 1980 and 1981. The share going to each technology-related sector except medical and health (and this is not exclusively high tech) increased in 1981. Many firms believe this emphasis is justified by the higher rate of return on new technology investments. Rate of return data for the industry are not generally available by type of investment, but some venture capital firms apparently have experienced returns of over 25 percent a year on high tech versus less than 20 percent on other investments. High tech often holds in addition the possibility of occasional very high returns ("upside potential" or "positive skew"), while more mundane projects do not.

Venture Capital in the Southeast

Venture capital firms in the Southeast exhibit the same interest in technology, as these national figures show. Table 3 lists the venture capital firms for eight southeastern states as of 1982. Fully 27 of the 39, or 69 percent, are SBICS or

³Stanley Pratt, "Special Report - Venture Capital Disbursements, 1981: A Statistical Overview." **Venture Capital Journal**, June 1982, p. 8.

Table 2. Venture Capital Disbursement by Industry

	Percent of Total Number of Investments		Percent of Dollar Amount	
	1981	1980	1981	1980
Communications	11.4%	11.5%	11.2%	10.9%
Computer Related	30.0	27.4	34.3	25.7
Other Electronics Related	14.5	9.6	13.1	9.6
Genetic Engineering	6.2	4.2	11.2	7.6
Medical/Health Related	7.0	10.5	5.8	9.3
Energy	4.9	8.3	5.8	19.9
Consumer Related	4.9	7.5	1.9	3.7
Industrial Automation	6.2	4.5	5.3	2.7
Industrial Products	4.4	3.6	3.4	2.0
Other	10.5	12.9	8.0	8.6
TOTAL	100.0%	100.0%	100.0%	100.0%

Source: See Table 1.

MESBICs. Capital under management ranges from \$500,000 to \$17 million. A preference for high-tech investments was recorded as a "yes" if the information on the firm specifically stated that one or more of its target industries was a high-tech field. If it listed no preferences (as in about 30 percent of the cases) or if its target industries were not high tech, the preference is listed as "no." On this basis, 18 firms, or 46 percent, are interested in high technology either exclusively or among other interests.

Most venture capital in the Southeast seems to be concentrated in Florida and Georgia; these two states together claim 60 percent of the funds listed in Table 3. The firms in Georgia, with one exception, are in Atlanta, while those in Florida are more dispersed. For the country as a whole, venture capital is concentrated in areas with a record of producing new (and high-technology) industry. A large proportion of the venture funds are based in New York, Boston, Chicago, Minneapolis and California. This raises a chicken and egg problem as far as economic growth is concerned. Is the presence of a large venture capital pool a prerequisite for the growth of new industry, or does industry's growth potential attract venture firms?

Professional venture capitalists generally hold that they are funding all of the projects that look promising, and that investment is constrained by profitability, not the supply of venture capital. State officials interested in fostering growth, on the other hand, believe that capital is the scarce resource and that more venture capital is needed, especially in areas without a large local pool of venture funds.

In the Southeast, high-technology manufacturing is more dispersed than the supply of venture capital. Table 4 presents the distribution of high-tech industry by state for the region. Our definition of high tech covers the three- and four-digit Standard Industrial Classification codes in Table 4; the two-digit industries are shown because they are the more inclusive industrial categories which in most cases are closely related to the smaller high-tech fields within each. The totals at the bottom of the table show the high-tech industries as a percent of their larger two-digit categories as well as their size as a percent of total manufacturing in each state. Florida, not surprisingly, has the largest absolute and relative amount of high-tech employment. Florida also boasts the categories of employment that are most unambiguously high tech. There is always a difficult problem in defining this type of industry from Census data, since all classifications include a wide variety of products, components and accessories. But Florida has the region's largest employment in computer production (3573), communication equipment (366) and aerospace (376), all of which are for the most part technically advanced types of production processes.

Georgia ranks only sixth of the eight states in the amount of high-tech employment, and its employment in these fields is only 3 percent of total manufacturing, the lowest share in the region. It also ranks only fourth in the total employment in the two-digit industries of machinery, electronics, instruments, rubber and plastics. These industries are mostly concentrated in heavily industrialized North Carolina and

Table 3. Private Venture Capital Firms in the Southeast, 1982

State	Location	High Tech Preference	Age	Type	Capital
Alabama	Birmingham	yes	7	P*	\$1,000,000
	Fayette	yes	NA**	SBIC	NA
Florida	Palm Beach	no	18	P	NA
	Orlando	yes	12	P	4,000,000
	Ft. Lauderdale	yes	8	P	NA
	Sanford	no	8	CDC	10,000,000
	Gainesville	yes	6	P	NA
	N. Miami	no	3	SBIC	2,000,000
	Miami	no	1	MESBIC	500,000
	Miami	yes	20	SBIC	1,200,000
	Miami	no	12	SBIC	6,000,000
	Miami	yes	1	MESBIC	1,000,000
	Miami	yes	2	MESBIC	1,000,000
Miami	no	NA	MESBIC	5,000,000	
Georgia	Augusta	no	17	SBIC	
	Atlanta	no	10	P	17,000,000
	Atlanta	yes	7	P	NA
	Atlanta	no	NA	P	NA
	Atlanta	no	22	SBIC	11,100,000
Louisiana	Shreveport	yes	1	SBIC	500,000
	Covington	yes	NA	SBIC	NA
	Baton Rouge	yes	19	SBIC	4,600,000
	New Orleans	yes	4	P	500,000
	Baton Rouge	no	6	SBIC	1,700,000
	New Orleans	no	18	SBIC	NA
	Shreveport	no	1	SBIC	1,000,000
	Lafayette	no	6	MESBIC	2,000,000
Baton Rouge	yes	7	SBIC	5,000,000	
Mississippi	Olive Branch	no	3	SBIC	900,000
	Jackson	yes	6	SBIC	4,600,000
North Carolina	Charlotte	yes	19	SBIC	6,000,000
	Charlotte	no	18	SBIC	NA
	Charlotte	no	1	SBIC	2,000,000
	Winston-Salem	yes	10	MESBIC	4,500,000
South Carolina	Hilton Head	no	3	SBIC	500,000
	Charleston	no	18	SBIC	3,000,000
	Greenville	no	7	P	NA
Tennessee	Memphis	no	3	MESBIC	1,000,000
	Knoxville	yes	12	P	NA

Source: Stanley Pratt, **Guide to Sources of Venture Capital**, 1982

*P denotes a private venture capital firm.

**NA denotes not available

Table 4. High Technology Manufacturing Employment in the Southeast
(In Thousands of Workers)

SIC	ALA	FLA	GA	LA	MISS	NC	SC	TN
30	14.8	10.8	2.5*	1.75	2.5	21.9	12.5	21.6
35	13.0	20.9	16.2	9.3	11.9	33.0	27.3	29.7
36	14.7	41.9	15.8	10.2	18.3	40.1	17.4	38.1
366	4.9	20.4	2.3	2.5*	1.75	9.2	1.9	2.5*
367	1.7	9.9	0.5	—	0.4	5.1	6.7	2.7
37	17.0	36.7	30.8	22.1	31.3	11.3	2.5*	25.4
372	2.5*	2.5*	2.5*	—	—	0.38	0.2	1.7
376	1.7	7.8	—	1.7	—	—	0.2	—
38	2.5	8.3	4.0	0.7	2.0	8.4	4.7	3.8
TOTALS								
1. 2-digit	62.0	118.6	69.3	59.8	66.0	114.7	64.4	118.6
2. 3-and 4-digit**	16.78	56.2	15.6	7.28	8.95	36.26	25.41	23.05
(2) / (1)	0.27	0.47	0.23	0.12	0.14	0.32	0.39	0.19
(2) as percent of manufacturing employment	0.05	0.16	0.03	0.04	0.04	0.05	0.07	0.05

U. S. Bureau of the Census
Standard Industrial Classifications

30	Rubber and Plastics	37	Transportation Equipment
35	Machinery, Except Electrical	372	Aircraft and Parts
36	Electrical and Electronic Equipment	376	Aerospace Equipment
366	Communication Equipment	38	Instruments
367	Electronic Components		

Source: U.S. Bureau of the Census, Census of Manufacturers, 1977.

*Indicates that employment is "over 2,500".

**Includes a number of minor classifications not shown

Tennessee. Table 4 demonstrates that the high technology industries seen as a springboard for growth generally represent only a fraction of the labor force. To generate a significant amount of economic growth, new high-tech companies must stimulate other areas of the economy, such as other manufacturing, finance, insurance and real estate, business services and transportation. It is with this broad-based growth in mind that many states are putting money into the venture capital field.

Federal and State Venture Capital Programs

The central debate with venture capital concerns the efficiency of capital markets. If there is shortage of seed capital for new firms because the capital market is not adequately serving these needs, then public programs designed to make more money available presumably will

stimulate economic growth. If, on the other hand, venture capitalists are already identifying and funding the projects that are good risks, then throwing more money at this area may lead to an increase in business failures, producing economic waste. The striking success of the SBIC program, as measured by its size and the success of the businesses funded, suggests that public policy can make a positive contribution to fostering new business. On the other hand, the largest increase in SBIC investment has come since the late 1970s and may have coincided with an increase in the opportunities for new business arising from technological developments. Many professional venture capitalists are concerned that the dramatic increase in financings since the late 1970s has already saturated the market. They are concerned that the returns earned on venture capital projects cannot be maintained at their current level and will not justify the risks assumed in such investment. However, many

public programs do not compete directly with private firms because they are targeted to specific industries, to economically depressed areas or to firms that have government contracts.

Federal programs to stimulate small business include several small targeted efforts and one major program that overshadows all others, the Business Loan Program of the Small Business Administration. The SBA lends over \$200 million annually through direct loans and over \$1.5 billion in guaranteed loans. Loans are guaranteed up to 90 percent and interest rates run about 2.5 percent above prime. Direct loans are targeted to small firms that have been turned down for conventional bank loans; the maximum loan is \$500,000 and rates are slightly over prime.

The SBA is the most important source of funding for small business, but in recent years other programs have been initiated to foster various public policy goals. The Small Business Innovations Research Program, administered by the National Science Foundation, is designed specifically to encourage new technology. The NSF makes around 80 small awards each from a \$2.4 million budget. The Appropriate Technology Small Grants Program administered by the Department of Energy is similarly targeted at small businesses with new products and processes. With a budget of \$1.5 million, it funds energy-related projects "appropriate to local needs and skills." The associated Energy-Related Inventions Program considers all energy-saving technologies under its \$1.7 million annual budget.

States have taken various approaches to fostering small business, from guaranteed loans to equity capital and even product investment. Many of these programs appeared first in states that were incubators of new industries and technologies, such as Massachusetts, Minnesota and California. It became clear in these states that growth was occurring in technologically innovative fields, while older industries were stagnant or declining. This revelation occurred much later in the Midwest, where traditional industries continued to grow until the late 1970s, and in the South, where almost all industries were growing. Today the Midwest is looking hard for potential sources of growth and the South is looking to the future, asking whether it can count on continued growth from existing industry as the rate of change in the nation's industrial economy accelerates. States in the Midwest and the South have recently begun to look at programs adopted in the older industrial states to assess their potential for economic growth.

Several possible directions for government initiatives are suggested in the programs described below.

Direct Loans and Equity Financing

The Massachusetts Technology Development Corporation is a publicly funded but independently operated venture capital organization. It was capitalized initially in 1979 by a \$2 million grant from the Economic Development Administration to establish a revolving loan fund for business operations involving a significant amount of technology. It was awarded an additional grant of \$1 million in 1981 by the U. S. Commerce Department's Corporations for Innovative Development Program, an amount matched by the state legislature to bring total capitalization to \$4 million. MTDC provides capital to new and expanding companies oriented toward industrial and commercial applications of new products and technologies. The investments are aimed not at initial development but rather where funding is needed to follow up promising new technologies already developed.

MTDC makes both debt and equity investments, often combining the two, and requires that its investment of between \$75,000 and \$300,000 be accompanied by two to four times that amount in private sector funds. The program has invested approximately \$2.7 million out of the fund thus far, along with private sector funding of about \$12 million. There have been no writeoffs to date, and MTDC estimates that the companies it has funded have created 1,000 jobs directly and about 1,400 others indirectly.

The Massachusetts Community Development Finance Corporation represents a different approach to public venture capital investment. CDFC is a public entity funded in 1975 by \$10 million in general obligation revenue bonds. Its purpose is to create employment in economically depressed areas, working through local Community Development Corporations. The business applying for funding must demonstrate the potential to increase employment at 150 percent of the minimum wage and show that it was unable to obtain private funding. Financing can be debt or equity, but CDFC cannot hold more than 49 percent ownership. Beginning the 1982 fiscal year, investments ranged from \$15,000 in a solar panel manufacturer to \$427,000 in an upholstered furniture firm. Most applicants are in manufacturing although some provide services and one was a real estate partnership. CDFC has

been less successful than most venture capital agencies because of its mandate to assist depressed areas, and several investments have been terminated. For fiscal 1981 it reported a loss on its venture funds, although it has an overall gain because most of its \$10 million still is held in short-term, non-venture assets. The state believes that CDFC is fulfilling its purpose of reducing unemployment in economically troubled areas even though its investments have had little success.

The Minnesota Small Business Finance Agency uses tax-exempt financing to provide capital to young businesses. Established in 1980, MSBFA serves firms that meet the SBA definition of a small business, but it avoids those in financial services, real estate, professional services and some others. After tax-exempt bonds are issued by the state, MSBFA must find a purchaser for the bonds, and the financing is then accomplished with no state expenditure other than the foregone taxes. Five financings have been completed, ranging from \$75,000 to \$265,000, for established businesses in traditional industries such as printing. Interest rates are at 75 percent of prime.

Minnesota also has two programs targeted for redevelopment of depressed areas. The Area Redevelopment Administration Loan Program since 1961 has been making loans below the prime rate for start-ups and expansions. To date, \$3.5 million has been lent, and the program has experienced \$573,000 in non-performing loans. Since the lending is done at subsidized rates and no equity positions are taken by ARA, the performance of this type of program is difficult to compare with a private venture capital firm. The state is seeking to increase employment, and the economic efficiency of the businesses is not measured against alternative uses of the funds. The second program, the Minnesota Revolving Loan Fund, is even further removed from the market place. It was established in 1980 with funds from the Economic Development Administration to provide financing below market interest rates to new or existing manufacturers. It targets several counties in the state with particularly depressed conditions. Only two loans have been made so far and no assessment of the program's success has been made.

A unique venture capital concept is being pioneered in the Connecticut Product Development Corporation. CPDC was funded in 1972 through the issuance of general revenue bonds;

its current capitalization is \$7 million. CPDC is unique for several reasons. First, it is product-oriented and, second, it does not take debt or equity positions in its investments. Companies with potentially marketable products approach CPDC and they work out a business plan together for the product. If CPDC feels the plan has potential for success, it will invest as much as 60 percent of total development costs. If the product is successful, CPDC collects 5 percent of gross sales until the original investment is recovered. After that, collections are reduced to 0.5 percent of sales for an amount of time equal to that period when 5 percent was collected. If the product is a failure, then the borrower's obligation ends with no required payback.

Since 1972, CPDC has committed \$5.2 million to 38 companies for 47 commercial and industrial products. Of these 47 products, 26 are currently on the market. These projects have created an estimated 214 additional jobs during the development stage and will create 1,500 more as the market for the products expands. There have been only seven failures in 10 years for a total write-off of \$162,000.

A more common route for a state government to take than equity financing or product investment is loan guarantees, since these do not require the expenditure of state funds unless losses are sustained. Guarantees encourage private lenders to finance seed capital and involve relatively small state staffs and line budgets. The agency assumes only a contingent liability requiring a loan loss reserve fund of some percentage of outstanding guarantees. Frequently the agencies are self-supporting, if fees based on the amount of principal guaranteed are adequate to meet loan losses and overhead expense.

One such loan guarantee program is the Louisiana Business Equity Corporation. LBEC was founded in 1982 at \$22 million but did not begin operations until 1983. The funds were deposited in 16 banks, drawing interest that serves as the operating budget. A nine-member board appointed by the governor must approve all investment decisions. LBEC'S purpose is to provide partial loan guarantees for loans made to SBICs, MESBICs and other small business lenders. For lenders to receive LBEC guarantees, they must qualify and pay a membership fee, which goes into the LBEC capital pool. Louisiana hopes the loan guarantees will stimulate SBIC financing and help disadvantaged individuals in depressed areas of the state.

The Massachusetts Industrial Finance Agency is one of the largest state loan guarantee programs for new ventures. It provides industrial revenue bonds and loan guarantees for businesses in designated urban areas and for industrial firms anywhere in the state. MIFA is involved with companies in high-technology areas as well as more traditional industries such as textiles and fish processing. Since 1977 the agency has been involved in 55 projects with a total of \$50 million in loans and an average size of \$1.25 million.

A final general type of capital-funding agency is the non-public lending agency. One of the oldest and largest is the Massachusetts Business Development Corporation, founded in 1953, which provides loans for small businesses that cannot obtain all of their financial requirements from conventional sources. MBDC was capitalized through a stock sale to interested financial institutions. The investing institutions are subject to calls from MBDC for loans of varying amounts with terms up to five years and rates $\frac{1}{4}$ percent over prime. MBDC currently has \$31 million in available credit and has loaned over \$100 million since it was founded. It maintains a loan loss reserve of 5 percent. MBDC is considered a model in its field and has been credited with the creation of some 65,000 jobs in Massachusetts.

Summary and Conclusions

Economic growth that creates jobs and improves the standard of living has long been a major goal of public policy. Various past efforts directed at tax relief, easing of environmental regulations, and retraining of labor have enjoyed only limited and often transitory success. Today many growth efforts aim to provide capital for new businesses that offer the largest portion of new jobs.

A rather well defined venture capital industry in the United States is composed of private firms, government related firms and corporate firms. Supplementing these firms are a series of federal and state program or agencies intended to provide capital to attractive new businesses that for some reason are not served by the venture capital industry. The total volume of venture capital has grown dramatically in recent years and the central question today is whether more venture capital is needed to support potentially

successful new businesses or if existing venture capital has matched the supply of new businesses with attractive prospects.

There is some truth in both positions. The overall capital markets are relatively efficient at providing funds to the venture capital industry when the industry offers projects with risk and return characteristics more attractive than competing uses of funds. However, new business financing involves tremendously high information costs that must be subtracted from prospective returns before determining any project's prospective risk and return and thus before the capital markets consider the project in relation to competing uses of funds. For this reason, high information costs can mean that attractive projects will go unfunded and both positions stated above will be true.

Consider all the dimensions of information costs. First, the new business must locate a source of venture capital. Then the venture capital source must (1) review the prospect, (2) structure an appropriate financial package if review is favorable, and (3) assist in the ongoing management of the business until the initial public offering. This sequence involves considerable time and requires a substantial amount of financial and general management talent. It is particularly expensive in smaller cities where most people in the Southeast live.

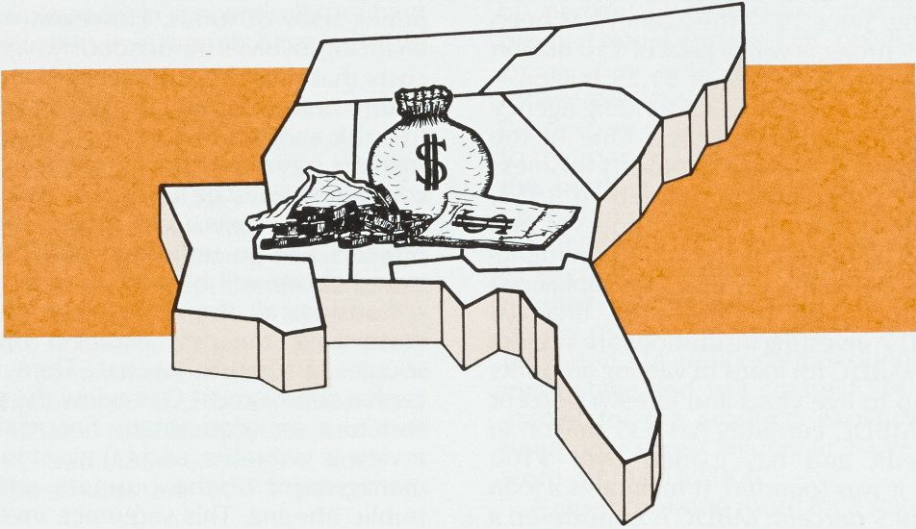
Future initiatives should involve plans to reduce the high information costs restricting the venture capital industry's ability to provide all of the capital that might be useful in stimulating new business growth. Many public programs will continue to emphasize methods of increasing investment that require limited expenditures of public funds, such as loan guarantees. While this does increase the supply of capital to small business, there is some question regarding the creditworthiness of some firms so funded. The alternative is to establish a capitalfunding agency designed to be self-supporting. This type of agency would compete directly with private venture capitalists, and to remain viable it would have to do the same exhaustive investigation of the ventures before investing.

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Note: This paper was presented at an Atlanta Fed Research Seminar on April 13, 1983.

Commercial Bank Profits: Southeastern Banks Fare Well



After underperforming the nation from 1974 through 1979, banks in the Southeast have enjoyed higher profit measures than the rest of the nation ever since. Banks in Georgia and Louisiana remained highly profitable last year, while Mississippi and Tennessee banks felt more noticeable effects from the recession.

Bank profits reflect the economic environment, the condition of specific bank markets, the level of market interest rates and the degree of regulation under which banks operate. This past year the overall weakness in the U. S. economy was reflected in bank profitability. Three key measures of profitability—adjusted net interest margin, return on assets and average return on equity—all dropped in 1982.¹ Adjusted net interest margin dropped from 3.86 percent to 3.76 percent, return on assets dropped from 0.76 percent to 0.72 percent, and average return on equity dropped from 13.1 percent to 12.2 percent. The declines, however, were not uniform across bank size or location.

The decline in bank profits was most pronounced among the smallest banks (with assets of \$25 million or less), while those with assets between \$50 million and \$100 million saw profits drop only slightly. These smallest banks saw their return on assets decline from 1.21 percent in 1981 to 1.04 percent in 1982 and their return on equity drop from 12.9 percent to 10.9 percent. Banks with assets between \$50 and \$100 million saw return on assets drop slightly from an average of 1.09 percent in 1981 to 1.08 percent in 1982; their return on equity dropped only from 13.5 percent to 13.3 percent.

Banks in the six southeastern states fared better than their national counterparts, averaging

¹Please see the Appendix for an explanation of the calculation of these ratios. Note especially that this analysis uses an expected tax equivalent net

interest margin that includes adjustments for taxes saved on tax exempt securities and for loan loss provisions.

Table 1. Adjusted Net Interest Margin
All Insured Commercial Banks
By Size Category

Year	All Banks	Year End Assets (\$ millions)					
		0 - 25	25 - 50	50 - 100	100 - 500	500 - 1000	1000+
1972	3.20	3.66	3.66	3.61	3.57	3.50	2.71
1973	2.95	3.58	3.63	3.50	3.36	3.35	2.35
1974	3.27	4.34	4.08	3.88	3.79	3.65	2.57
1975	3.11	4.07	3.91	3.83	3.76	3.63	2.37
1976	3.79	4.11	3.98	3.95	3.82	3.80	3.62
1977	4.13	4.14	4.10	4.06	3.96	3.86	4.25
1978	4.20	4.36	4.30	4.24	4.18	4.15	4.17
1979	3.95	4.71	4.50	4.42	4.29	4.29	3.57
1980	3.93	4.96	4.67	4.54	4.35	4.37	3.46
1981	3.86	5.13	4.70	4.53	4.37	4.39	3.35
1982	3.76	4.87	4.61	4.52	4.33	4.30	3.27

Source: Reports of Condition and Income
Note: Please see the Appendix for an explanation of these variables.

0.99 percent return on assets and 13.6 percent return on equity in 1982. Southeastern banks have not escaped the recent recession, however. Their adjusted net interest margin, return on assets and return on equity fell in 1982. Performance across the six states reflects the degree to which various states are being affected. Banks in relatively prosperous Georgia were far more profitable than banks in Mississippi and Tennessee, both hard hit by the recession.² Somewhat surprisingly, however, Louisiana banks were not as affected by falling oil prices as were other Louisiana businesses in 1982.

Profitability Measures

The three profitability measures used in this study generally tell the same story about declining bank profits, but there are significant differences in what they measure. The ratio adjusted net interest margin is calculated by subtracting a bank's interest expense from its interest revenue net of loan losses and dividing that result by its interest earning assets.³ That ratio measures the spread between the bank's interest income and its interest expense. It would be roughly analogous

to a business' margin. The ratio return on assets, obtained by dividing a bank's net income by its assets, provides a handy gauge of how well a bank's management is using its assets. The ratio return on equity is calculated by dividing a bank's net income by its shareholder's equity. That is the most important figure to a bank's shareholders because it tells them what the bank is earning on the funds they invested in the bank.

One important difference in these measures can be seen by comparing the ratios of the smallest banks, those with \$25 million in assets or less, with ratios of the largest banks, those with over \$1 billion in assets. The smallest banks generally enjoy larger spreads between their return on funds and their cost of funds (as measured by their adjusted net interest margins in Table 1) and make more profitable use of their assets (as measured by their returns on assets in Table 5). The largest banks generally provide the higher returns to their stockholders as measured by their return on equity in Table 6. They have higher returns on equity in spite of their lower adjusted net interest margins and lower return on assets because they have less equity capital per dollar of assets than the smaller banks. This

²In this article, the "Southeast" refers to the six states all or partially within the Sixth Federal Reserve District: Alabama, Florida, Georgia, Louisiana, Mississippi, and Tennessee. See the February 1983 issue of this *Economic*

Review for an analysis of economic conditions in the Southeast.
³See the Appendix for a description of exactly how each variable is calculated.

Table 2. Tax Equivalent Interest
All Insured Commercial Banks
By Size Category

Year	All Banks	Year End Assets (\$ millions)					
		0 - 25	25 - 50	50 - 100	100 - 500	500 - 1000	1000+
1979	11.35	9.50	9.60	9.66	9.85	10.28	12.66
1980	13.08	11.11	11.05	11.02	11.17	11.40	14.61
1981	15.53	13.25	13.09	13.03	13.31	13.59	17.22
1982	14.56	13.70	13.38	13.26	13.26	13.20	15.42

Source: Reports of Condition and Income
Note: Please see the Appendix for an explanation of these variables.

Table 3. Loan Loss Provision
All Insured Commercial Banks
By Size Category

Year	All Banks	Year End Assets (\$ millions)					
		0 - 25	25 - 50	50 - 100	100 - 500	500 - 1000	1000+
1979	.31	.30	.27	.27	.26	.30	.33
1980	.33	.33	.30	.29	.29	.35	.35
1981	.34	.37	.31	.31	.32	.32	.35
1982	.51	.52	.46	.43	.47	.48	.53

Source: Reports of Condition and Income
Note: Please see the Appendix for an explanation of these variables.

Table 4. Interest Expense
All Insured Commercial Banks
By Size Category

Year	All Banks	Year End Assets (\$ millions)					
		0 - 25	25 - 50	50 - 100	100 - 500	500 - 1000	1000+
1979	7.10	4.49	4.83	4.97	5.30	5.69	8.76
1980	8.82	5.83	6.08	6.19	6.52	6.68	10.80
1981	11.33	7.75	8.08	8.20	8.62	8.88	13.51
1982	10.30	8.30	8.31	8.31	8.46	8.42	11.62

Source: Reports of Condition and Income
Note: Please see the Appendix for an explanation of these variables.

allows the large banks to use debt to leverage up their return on equity.⁴

Banks' Adjusted Net Interest Margins

Last year's drop in adjusted net interest margins continued a long trend. Adjusted net interest margins have been falling ever since they peaked at an average of 4.20 in 1978 (Table 1). From 1972 through 1978, margins had been increasing with the exception of dips in 1973 and 1975. The trends in adjusted net interest margin, however, are not uniform across the size categories. Adjusted net interest margins for banks with less than \$1 billion rose from 1975 through 1981, while margins on the largest category of banks have been falling since 1977. Adjusted net interest margins also have followed a pattern across size classes that has persisted through time. Margins at small banks are consistently larger than those for larger banks.

The changes in adjusted net interest margins since 1979 can be understood best by examining Tables 2 through 4, which contain the three components of adjusted net interest margin: tax equivalent interest revenue, loan-loss provisions, and interest expense.⁵ Both interest revenue and interest expense increased for the average of all banks from 1979 to 1981 and then decreased last year. Yet those averages fail to tell the whole story for 1982. While banks with assets in excess of \$100 million experienced decreasing interest revenue and expenses, banks with assets below \$100 million had increasing interest revenue and expenses. Loan-loss provisions, which had increased slightly from 1979 to 1981, jumped dramatically in 1982. All six size categories experienced the increase, with the very largest banks having the biggest jump. These increased loan-loss provisions thus account for 1982's general decline in margins.

Tax equivalent interest revenues and interest expense figures reveal some important differences between large and small banks. In 1979, banks with assets of \$100 million or less had interest expenses that were 3.8 to 4.3 percentage points below the expenses of banks with assets in excess of \$1 billion. The smaller banks also earned tax equivalent revenue that is 3.0 to 3.2

percentage points below the \$1 billion-plus banks. The expense difference fell to approximately 3.3 percentage points in 1982 while the revenue difference dropped to 1.7 to 2.2 percentage points. Small banks were paying below-market rates for their funds in 1979 and charging customers below-market rates for their loans. The deregulation of interest rates has forced up the cost of funds at small banks since 1979, and these banks have responded by charging more for their loans. Indeed, while large banks' interest revenue and expenses fell with the decrease in market rates in 1982, the revenues and expenses of small banks continued to rise as these banks' customers moved their money to deregulated accounts and the banks compensated by charging more for loans.

Some data suggest that banks are trying to offset loan losses partially with higher interest revenues. The increase in loan losses exceeded the decline in adjusted net interest margins for all but the smallest banks. Some critics allege that banks are keeping loan rates high deliberately to offset their loan losses. This is an unfair criticism to the extent that banks are merely charging their risky customers more because these customers are more likely to default during this recession than they were during previous years. The critics have a valid point, however, to the extent loan rates remain high because banks are trying to offset losses on risky loans by charging good customers more. We cannot tell from these data which customers are paying the higher rates.

Banks' Returns On Assets and Equity

Banks' returns on assets and returns on equity have reflected trends in the economy, with high bank returns occurring during periods of economic strength and low returns occurring during periods of economic weakness. Banks' returns on assets dropped from their 1972 and 1973 average highs of 0.76 to a low in 1975 of 0.69 (Table 5). The returns then started climbing to an average high of 0.81 in 1979 and have declined since to a low of 0.72 in 1982. Banks' returns on equity have followed a trend similar to their returns on assets (Table 6). Average bank return on equity dropped from its 1973 peak of 12.8

⁴Large banks generally have lower capital because they hold a greater diversity of assets and therefore may be somewhat less likely to suffer large losses. They may also be more effective in resisting bank regulators' calls for more capital.

⁵Tax exempt interest revenue is adjusted by adding the taxes saved to the interest received. Loan-loss provisions are included as a part of net interest margin to obtain an expected interest revenue. This adjustment recognizes that some banks make higher risk loans that carry a higher interest rate and that these banks expect to have higher loan losses.

Table 5. Return on Average Assets
All Insured Commercial Banks
By Size Category

Year	All Banks	Year End Assets (\$ millions)					
		0 - 25	25 - 50	50 - 100	100 - 500	500 - 1000	1000+
1972	.76	.94	.95	.90	.86	.86	.62
1973	.76	1.06	1.01	.92	.83	.85	.60
1974	.71	1.05	.96	.89	.80	.79	.57
1975	.69	.91	.91	.87	.75	.76	.57
1976	.70	.95	.95	.92	.78	.77	.57
1977	.71	.97	1.02	.97	.85	.78	.56
1978	.76	1.03	1.07	1.02	.94	.83	.61
1979	.81	1.20	1.17	1.10	1.00	.88	.64
1980	.79	1.31	1.21	1.14	1.00	.88	.61
1981	.76	1.21	1.17	1.09	.94	.86	.60
1982	.72	1.04	1.11	1.08	.88	.79	.57

Source: Reports of Condition and Income
Note: Please see the Appendix for an explanation of these variables.

Table 6. Return on Average Equity
All Insured Commercial Banks
By Size Category

Year	All Banks	Year End Assets (\$ millions)					
		0 - 25	25 - 50	50 - 100	100 - 500	500 - 1000	1000+
1972	12.2	11.7	13.1	12.9	12.5	12.7	11.8
1973	12.8	13.5	13.9	13.4	13.3	13.2	12.4
1974	12.5	12.9	12.9	12.6	11.7	12.5	12.7
1975	11.8	10.9	12.1	12.0	10.7	11.6	12.4
1976	11.5	11.2	12.4	12.2	11.0	11.5	11.4
1977	11.8	11.3	13.2	12.9	12.1	11.6	11.3
1978	12.9	12.0	13.6	13.6	13.4	12.8	12.7
1979	13.9	13.6	14.5	14.3	14.1	13.5	13.8
1980	13.7	13.4	14.6	14.4	13.8	13.1	13.4
1981	13.1	12.9	13.7	13.5	12.8	12.7	13.1
1982	12.2	10.9	13.0	13.3	12.0	11.7	12.1

Source: Reports of Condition and Income
Note: Please see the Appendix for an explanation of these variables.

Table 7. Adjusted Net Interest Margin
 All Insured Commercial Banks
 In Six Southeastern States
 By Size Category

Year	All Banks	Year End Assets (\$ millions)					
		0 - 25	25 - 50	50 - 100	100 - 500	500 - 1000	1000+
1972	3.85	3.94	3.88	3.99	3.75	3.55	4.05
1973	3.55	3.86	3.90	3.94	3.42	2.90	2.92
1974	3.82	4.49	4.15	3.97	3.72	3.31	2.97
1975	3.58	4.13	3.84	3.76	3.60	3.29	2.58
1976	3.82	4.27	3.98	3.92	3.72	3.50	3.35
1977	3.98	4.28	4.20	4.17	3.94	3.55	3.60
1978	4.25	4.52	4.41	4.29	4.30	3.97	3.91
1979	4.57	4.85	4.68	4.62	4.63	4.38	4.28
1980	4.78	5.11	4.87	4.97	4.82	4.42	4.54
1981	4.79	5.14	4.90	4.87	4.75	4.79	4.72
1982	4.73	4.73	4.67	4.82	4.69	4.65	4.76

Source: Reports of Condition and Income

Note: Please see the Appendix for an explanation of these variables.

percent to a 1976 low of 11.5 percent, it then started increasing until it peaked at 13.9 percent in 1979. Banks' returns on equity dropped from 1979 to 1982 with last year's value being 12.2 percent. Averages of the various size categories have generally followed this overall pattern.

Bank returns through time have also followed a consistent pattern across the various size classes. Banks' returns on assets almost always decreased as bank size increased from 1972 through 1982. Banks with assets between \$25 million and \$100 million usually had the highest returns on equity between 1972 and 1982. Banks with assets of less than \$25 million and banks with assets between \$500 million and \$1 billion generally had the lowest return on equity during those years.

Thus, bank profits were down for all three measures of profitability for every size group examined. Sharp increases in loan-loss provisions appear to have been a major factor in the declining profits. The drop in bank earnings does not necessarily mean, however, that bank shareholders were worse off in 1982. The value of a bank's stock depends not only on the bank's earnings but the rate of return on competitive

investments and the riskiness of banks. If the return on other investments drops, then the required return for banks also drops. If the riskiness of banks goes up, then their required return goes up. Interest rates dropped in 1982, offsetting at least some of the decline in bank profits. Bank loan losses went up, however, which may indicate that banks are more risky.⁶

Profitability of Banks in the Southeast

In general, southeastern banks have been more profitable than banks across the nation in recent years (Tables 7-12). In sharp contrast to the national trend discussed above, adjusted net interest margins in the region have tended to go up throughout the period 1972 through 1982. The region's banks started the period averaging 3.85 percent, and saw the average drop in 1973 to 3.55 percent and again in 1975 to 3.58 percent. Yet it has been rising almost continuously since. The ratio peaked at 4.79 in 1981, but

⁶The increase in loan losses means that individuals who invest only in bank stocks face greater risks, but it is not obvious what the effect of the losses are on investors who own a diversified portfolio of stocks.

Table 8. Net Interest Margin
All Insured Commercial Banks
In Six Southeastern States
By Size Category

Year	All Banks	Year End Assets (\$ millions)					
		0 - 25	25 - 50	50 - 100	100 - 500	500 - 1000	1000+
1979	10.14	9.78	9.76	9.80	9.95	10.58	11.05
1980	11.63	11.41	11.29	11.26	11.44	11.63	12.62
1981	13.81	13.34	13.37	13.27	13.40	13.90	14.97
1982	13.56	13.66	13.46	13.45	13.20	13.60	14.05

Source: Reports of Condition and Income
Note: Please see the Appendix for an explanation of these variables.

Table 9. Loan Loss Provision
All Insured Commercial Banks
In Six Southeastern States
By Size Category

Year	All Banks	Size Category (\$ millions)					
		0 - 25	25 - 50	50 - 100	100 - 500	500 - 1000	1000+
1979	.39	.43	.36	.41	.32	.43	.50
1980	.41	.45	.39	.33	.35	.44	.52
1981	.39	.48	.41	.35	.35	.31	.45
1982	.48	.66	.53	.47	.43	.53	.46

Source: Reports of Condition and Income
Note: Please see the Appendix for an explanation of these variables.

Table 10. Interest Expense
All Insured Commercial Banks
In Six Southeastern States
By Size Category

Year	All Banks	Year End Assets (\$ millions)					
		0 - 25	25 - 50	50 - 100	100 - 500	500 - 1000	1000+
1979	5.19	4.50	4.72	4.84	5.00	5.77	6.26
1980	6.45	5.86	6.02	5.97	6.27	6.77	7.55
1981	8.64	7.73	8.05	8.06	8.42	8.80	9.80
1982	8.36	8.27	8.27	8.17	8.09	8.32	8.84

Source: Reports of Condition and Income
Note: Please see the Appendix for an explanation of these variables.

Table 11. Return on Assets
 All Insured Commercial Banks
 In Six Southeastern States
 By Size Category

Year	All Banks	Year End Assets (\$ millions)					
		0 - 25	25 - 50	50 - 100	100 - 500	500 - 1000	1000+
1972	.97	1.04	1.02	1.08	.92	.90	.82
1973	.97	1.14	1.10	1.12	.89	.73	.74
1974	.81	1.02	.95	.92	.79	.68	.45
1975	.68	.78	.80	.76	.65	.67	.44
1976	.73	.82	.83	.78	.71	.75	.52
1977	.79	.84	.94	.92	.77	.70	.58
1978	.88	.94	1.03	.99	.90	.76	.69
1979	1.04	1.12	1.16	1.13	1.06	.88	.91
1980	1.09	1.19	1.23	1.26	1.11	.93	.89
1981	1.02	1.16	1.18	1.19	1.00	.96	.85
1982	.99	.93	1.10	1.16	1.01	.90	.90

Source: Reports of Condition and Income
 Note: Please see the Appendix for an explanation of these variables.

decreased only slightly to 4.73 in 1982. The margins for the individual size categories followed the same basic pattern as the regional averages, but there were some significant discrepancies.

Particularly noticeable are the relatively large declines between 1981 and 1982 in the adjusted net interest margins of the two small bank categories. This drop can be explained by looking at the components of adjusted net interest margins for southeastern banks in Tables 8 through 10. Interest revenue increased only slightly at these banks, while their loan-loss provisions and interest expense both increased sharply.

One contrast between the nation and the region is the time trends in the adjusted net interest margins of those banks with over \$1 billion. The national average for these banks peaked in 1977 and has been falling every year since then. The southeastern states' average bottomed out in 1975 and has been rising ever since. In addition, banks across the country had lower adjusted net interest margins in 1982 as their size increased, while banks in the Southeast experienced relatively little change in their margins as their size increased. Another difference is in the loan-loss provisions of banks with assets in excess of \$1 billion. While banks across the nation and in the Southeast reported sharply higher loan losses in 1982, the largest banks in

the Southeast reported only slightly higher loan losses.

Southeastern banks' overall average return on assets (Table 11) and return on equity (Table 12) followed the same pattern as the national trend. The trends are common to all six size categories for almost every year from 1972 to 1982. Two interesting exceptions are the upturns between 1981 and 1982 in both ratios for banks in the \$100 million to \$500 million category and in the \$1 billion and larger category. With these two exceptions, bank profitability dropped from 1981 to 1982, with the smallest banks suffering the largest drops.

A comparison of profitability of southeastern banks versus banks across the nation reveals significant differences across the six size categories. Southeastern banks with assets of less than \$50 million generally had larger adjusted net interest margins than their peers across the nation, but their return on assets and return on equity were usually below their peers since 1974. Southeastern banks in the four size categories from \$50 million to more than \$1 billion all followed the same basic pattern. All three measures of profitability for these banks dropped below national averages between approximately 1974 and 1978 but have been above the national averages from 1979 to 1982.

Table 12. Return on Equity
All Insured Commercial Banks
In Six Southeastern States
By Size Category

Year	All Banks	Year End Assets (\$ millions)					
		0 - 25	25 - 50	50 - 100	100 - 500	500 - 1000	1000+
1972	13.5	12.7	14.3	15.4	13.4	12.4	12.8
1973	12.8	13.5	13.9	13.4	12.3	13.2	12.4
1974	11.3	11.9	12.8	12.3	11.3	12.3	7.4
1975	9.1	8.6	10.5	9.8	9.1	11.7	7.0
1976	9.6	9.0	10.5	9.9	9.5	12.2	7.9
1977	10.5	9.3	11.8	11.7	10.5	11.0	9.1
1978	12.0	10.6	12.8	12.9	12.3	11.9	11.4
1979	14.1	12.4	14.2	14.5	14.5	13.2	14.5
1980	14.5	12.8	14.4	15.7	15.1	13.6	14.2
1981	13.7	12.3	13.6	14.6	13.5	13.7	13.9
1982	13.6	9.9	12.6	14.1	13.8	12.9	14.9

Source: Reports of Condition and Income

Note: Please see the Appendix for an explanation of these variables.

Table 13. Adjusted Net Interest Margin
All Insured Commercial Banks
In Six Southeastern States
By State

Year	All Banks	States					
		Alabama	Florida	Georgia	Louisiana	Mississippi	Tennessee
1972	3.85	3.84	3.73	4.58	4.54	4.11	3.53
1973	3.55	3.72	3.68	3.85	3.14	3.77	3.13
1974	3.82	4.21	3.81	4.09	3.77	4.23	3.19
1975	3.58	3.99	3.48	3.70	3.75	4.20	2.94
1976	3.82	4.01	3.65	4.18	3.85	4.16	3.50
1977	3.98	3.98	3.88	4.30	3.99	4.10	3.79
1978	4.25	4.07	4.36	4.63	4.23	4.07	3.90
1979	4.57	4.27	4.83	5.10	4.58	4.08	4.03
1980	4.78	4.25	5.16	5.50	4.83	4.07	4.06
1981	4.79	4.29	5.07	5.58	5.04	3.90	3.99
1982	4.73	4.21	5.16	5.09	5.03	3.71	4.06

Source: Reports of Condition and Income

Note: Please see the Appendix for an explanation of these variables.

Table 14. Tax Equivalent Interest
All Insured Commercial Banks
In Six Southeastern States
By State

Year	All Banks	States					
		Alabama	Florida	Georgia	Louisiana	Mississippi	Tennessee
1979	10.14	10.41	9.84	10.78	10.33	9.72	10.12
1980	11.63	11.50	11.41	12.08	11.90	11.10	11.73
1981	13.81	13.70	13.54	14.06	14.23	13.22	14.00
1982	13.56	13.38	13.50	13.38	13.84	13.16	13.93

Source: Reports of Condition and Income
Note: Please see the Appendix for an explanation of these variables.

The Southeast also differed from the national pattern in the components of adjusted net interest margin. Tax equivalent revenue at southeastern banks usually exceeded that of the rest of the nation in every size category except the \$1 billion and larger banks. This higher revenue is explained at least partially by their higher loan losses. The southeastern banks had higher loan losses in every year in each of the six size categories with only three exceptions. They also had lower interest expenses than their counterparts, with the exception of banks with less than \$25 million in assets and those with \$500 million to \$1 billion in assets.

These figures show that southeastern banks have been more profitable than banks across the nation in the past few years. The Southeast has not been immune, however, to the effects of the recession. Banks in the region generally have reported lower profits recently, with increased loan-loss provisions an important factor behind the decline.

Profitability of Southeastern Banks by State

The profitability of banks in the various southeastern states varies widely. Florida, Georgia and Louisiana banks have all had adjusted net interest margins in excess of 5 percent for the last two years, while Alabama, Mississippi and Tennessee have had margins below 4.3 percent (Table 13). Mississippi banks, in particular, appear to be suffering much more in 1981 and 1982 than they did in 1974 and 1975. Louisiana's string of increasing adjusted net interest margins from

1973 to 1981 probably reflected the state's increasing oil income.

The individual components of adjusted net interest margin in the six states reveal the importance of minimizing loan-loss provisions and interest expense (Tables 14-16). The two states whose banks enjoyed the highest tax equivalent interest revenue in 1982 were Louisiana and Tennessee, with revenue of 13.8 and 13.9 percent respectively; the state with the lowest adjusted revenue was Mississippi, with 13.2 percent. Mississippi also experienced the highest loan losses in 1982, while Florida had the lowest losses. Of the three states with a high 1982 net interest margin (Florida, Georgia and Louisiana), only Louisiana also had unusually high interest revenue, but these three states had the lowest loan losses and lowest interest expenses of the six states.

The District states' returns on assets and returns on equity tell a similar story (Tables 17 and 18). In the past few years Georgia and Louisiana banks have been the most profitable, Mississippi and Tennessee the least profitable and Alabama and Florida somewhere in between. Alabama banks' returns on assets and equity in recent years have been somewhat better than their adjusted net interest margins would suggest, while Florida and Tennessee banks' returns were somewhat worse than one would expect given their adjusted net interest margins.

Florida and Tennessee banks' figures are especially interesting. Florida had better net interest margins than Georgia and Louisiana in 1982, yet it had significantly lower returns on assets and

Table 15. Loan Loss Provision
All Insured Commercial Banks
In Six Southeastern States
By State

Year	All Banks	States					
		Alabama	Florida	Georgia	Louisiana	Mississippi	Tennessee
1979	.39	.51	.30	.55	.34	.32	.39
1980	.41	.62	.30	.46	.39	.36	.44
1981	.39	.46	.30	.41	.39	.45	.45
1982	.48	.54	.34	.40	.52	.72	.61

Source: Reports of Condition and Income
Note: Please see the Appendix for an explanation of these variables.

Table 16. Taxable Interest Expense
All Insured Commercial Banks
In Six Southeastern States
By State

Year	All Banks	States					
		Alabama	Florida	Georgia	Louisiana	Mississippi	Tennessee
1979	5.19	5.36	4.72	5.13	5.40	5.33	5.69
1980	6.45	6.63	5.94	6.13	6.68	6.69	7.24
1981	8.64	8.95	8.19	8.07	8.80	8.87	9.56
1982	8.36	8.62	7.99	7.90	8.29	8.74	9.27

Source: Reports of Condition and Income
Note: Please see the Appendix for an explanation of these variables.

Table 17. Return on Assets
All Insured Commercial Banks
In Six Southeastern States
By State

Year	All Banks	States					
		Alabama	Florida	Georgia	Louisiana	Mississippi	Tennessee
1972	.97	1.04	.99	1.00	.92	1.07	.88
1973	.97	1.09	1.04	.98	.87	1.06	.79
1974	.81	1.05	.83	.74	.84	1.03	.56
1975	.68	.95	.56	.66	.86	.97	.45
1976	.73	.99	.54	.73	.90	1.02	.64
1977	.79	1.03	.67	.70	.91	.99	.75
1978	.88	1.00	.85	.83	.97	1.01	.76
1979	1.04	1.09	1.01	1.16	1.14	1.05	.85
1980	1.09	1.10	1.09	1.18	1.18	1.10	.88
1981	1.02	1.05	.90	1.24	1.25	1.01	.78
1982	.99	1.04	.95	1.11	1.22	.84	.75

Source: Reports of Condition and Income
Note: Please see the Appendix for an explanation of these variables.

Table 18. Return on Equity
All Insured Commercial Banks
In Six Southeastern States
By State

Year	All Banks	States					
		Alabama	Florida	Georgia	Louisiana	Mississippi	Tennessee
1972	13.5	13.5	14.4	13.4	12.1	14.7	12.5
1973	12.8	14.5	15.1	13.8	11.9	14.9	11.9
1974	11.3	13.9	11.4	10.4	11.8	14.0	8.3
1975	9.1	12.5	7.1	9.1	12.1	12.7	6.5
1976	9.6	12.8	6.7	9.5	12.2	13.3	9.1
1977	10.5	13.4	8.6	9.2	12.3	13.3	10.7
1978	12.0	13.1	11.3	11.5	13.3	13.9	10.9
1979	14.1	13.9	13.5	15.5	15.4	14.6	12.1
1980	14.5	13.5	14.8	15.5	15.7	14.8	12.4
1981	13.7	12.6	12.5	16.8	16.5	13.5	10.9
1982	13.6	12.7	13.7	15.3	15.8	11.3	10.8

Source: Reports of Condition and Income

Note: Please see the Appendix for an explanation of these variables.

equity. While Tennessee was the least profitable state for banking between 1972 and 1982, its adjusted net interest margins did climb above those of Mississippi in 1981 and 1982. Tennessee remained significantly below Mississippi, however, in the other two measures of profitability for those two years.

Are Bank Profits Starting to Plunge?

In 1981 one consulting firm said that annual bank profits could drop by as much as \$40 billion in the 1980s.⁷ (The firm noted, for comparison purposes, that bank profits in 1980 were approximately \$20 billion.) This consultant emphasized that the estimate of a \$40 billion drop in earnings was a "projection of an 'unmanaged outcome'" and not a prediction. The projection was based on two assumptions: banks were going to lose the interest subsidy that cheap deposits were providing and banks were going to continue experiencing high operating costs. Bank deposits

paid low interest rates because a government regulation called Regulation Q limited the rates banks could pay on checking and savings accounts. Banks faced higher rates for these accounts as Regulation Q was abolished.

The findings in our study do not prove the consulting firm wrong, but they certainly do not support its worst case (or "unmanaged") projections. Its concerns about the phaseout of Regulation Q do not seem to have been borne out, even though the interest subsidy that Regulation Q provides to banks was reduced in 1982, for three reasons: new accounts that pay higher rates of interest were authorized by regulators (most notably the money market deposit account last December), depositors have shifted more funds to deregulated accounts and the difference between market rates and the Regulation Q interest ceilings decreased throughout 1982 due to decreasing market rates. If the consultant's study was right about the loss of cheap deposits, then bank adjusted net interest margins should have dropped in 1982. Margins did decline, but primarily because of recession-induced loan loss increases. The effects of deregulation of bank interest rates certainly were felt by banks, especially small institutions, but banks were able to offset the higher cost of funds with higher interest earnings.

⁷McKinsey and Company, "Building a More Effective Commercial Banking System—Without Financial Chaos" June 1981. These findings were subject to the criticism that bank operating expenses were going up because banks were providing customers with additional free services to offset the low interest rates paid on certain accounts. Therefore, critics noted, banks should be able to reduce the free services as they increase the interest rate they pay on customers' accounts.

Conclusions

The profitability of banks across the nation and in the Southeast appears to be sensitive to the economic climate and the trends in regulation. The continuing recession reduced banks' 1982 profitability below 1981 levels with increased loan loss provisions playing a significant role in the decline. The effects of deregulation were particularly noticeable for small banks last year. These banks had increased interest earnings and increased interest expense even though market interest rates were falling in 1982. Banks in the

Southeast generally underperformed the nation during the period from 1974 through 1979, but they have outperformed the rest of the nation ever since. Southeastern banks again outperformed the nation in 1982, but their performances were also generally below their 1981 levels. While banks in Georgia and Louisiana remained highly profitable last year, banks in Mississippi and Tennessee were clearly feeling the effects of the recession.

—Larry D. Wall

APPENDIX

The Appendix describes the data source, explains the calculation of the three ratios, and lists the number of banks in each category. The data in this article are taken from the Reports of Condition and Income that insured commercial banks file with the Federal Reserve System. Data from the Reports of Condition have been modified at the Board of Governors to reflect bank mergers. The modifications attempt to match each bank's income with the assets used to produce that income. The pooling method of accounting combines the merged banks' income from the beginning of the year, whereas the purchase method combines their income as of the date of the merger. Therefore, for those mergers that were accounted for using the pooling method the balance sheet data are combined as of the beginning of the year. For those mergers using the purchase method, balance sheets are merged as of the beginning of the year if the merger took place during the first quarter of the year, and June balance sheets are merged if the merger took place during any of the first three quarters of the year.

The three profitability measures used in this study are defined as follows:

$$\text{Adjusted Net Interest Margin} = \frac{\text{Expected Interest Rev.} - \text{Interest Exp.}}{\text{Average Interest Earning Assets}}$$

$$\text{Return on Assets} = \frac{\text{Net Income}}{\text{Average Assets}}$$

$$\text{Return on Equity} = \frac{\text{Net Income}}{\text{Average Stockholder Equity}}$$

Average interest earning assets, average assets and average stockholders' equity are the average of the beginning, middle and end of the year balance sheet figures. The expected interest income component to net interest margin has two significant adjustments from ordinary interest income. One adjustment is that revenue from state and local securities that is exempt from federal income taxes is grossed up by the bank's marginal tax rate. This prevents banks from being penalized because they hold substantial portfolios of state and local securities to reduce their tax burden. The other adjustment is that loan losses are subtracted from interest income. This is done so that banks that make low-risk loans at low interest rates are placed on a more equal footing with those that make high-risk loans involving high interest income.

Due to changes in the reporting form used for the Reports of Condition and Income, exact definitions of

the items change slightly through time. The most significant change is that reporting forms filed through December 1975 contained a section, abolished in 1976, called "Reserves on Loans and Securities." This section contained three separate items: reserves for bad debt losses on loans (set up to comply with IRS rulings), other reserves on loans, and reserves on securities. The reserves for bad debt losses on loans are approximately equivalent to the reserve for possible loan losses item in the post-1975 form. The reserve for possible loan losses category on the post-1975 forms is deducted from gross loans to obtain net loans, and net loans are used to calculate total assets rather than gross loans. Therefore, for 1972 through 1975 the reserves for bad debt losses on loans are subtracted from interest earning assets and total assets. The other two categories—other reserves on loans and reserves on securities—represent a portion of undivided profits that has been allocated to cover potential future losses. This allocation had no economic significance and after 1975 all undivided profits were reported as one figure. Therefore these two reserve categories are added to stockholders equity for the figures from 1972 through 1975.

Another significant change is the treatment of leases. Lease income is similar in nature to interest from loans. Income from leases was included, however, in "other operating income" until 1976. Therefore lease income was excluded from expected interest income and leases were excluded from interest earning assets prior to 1976, but are included thereafter. Leases represented less than 2 percent of interest earning assets in 1976.

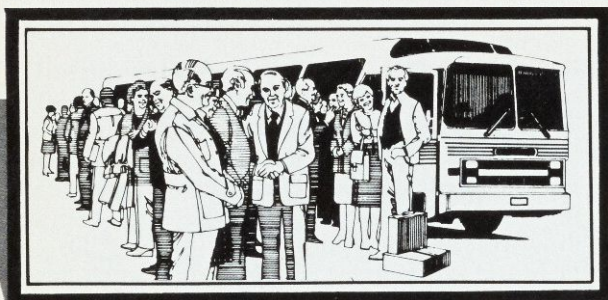
Table 1A gives the number of banks used to estimate the various ratios for all banks in selected years. The changes in the number of banks in the various size categories in the Southeast followed approximately the same pattern. To be included in the calculations, a bank had to exist at the end of the prior year and had to be in existence for the entire current year. That's because the balance sheet figures used to calculate the ratios are the average of the end of the prior year, and the middle and end of the current year figures. Therefore the number of banks listed in the tables does not equal the number in operation at the end of any year. One important trend to note in these tables is the falling number of banks in the under \$25 million category and the increasing number in the other five categories, a trend due in large part to inflation. The GNP deflator (the broadest measure of price changes) increased 107 percent from 1972 to 1982.

Table 1A. Number of Banks
In The Nationwide Samples
By Size Category

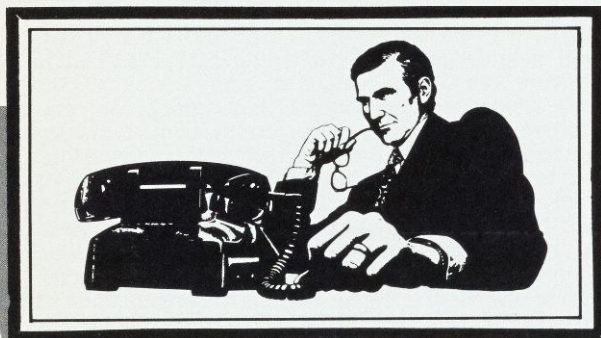
Year	All Banks	Year End Assets (\$ millions)					
		0 - 25	25 - 50	50 - 100	100 - 500	500 - 1000	1000+
1972	13486	10102	1742	860	594	98	90
1973	13634	9832	1954	967	683	96	102
1974	13852	9718	2136	1053	739	93	113
1975	14126	9534	2387	1187	808	97	113
1976	14240	9199	2640	1305	866	104	126
1977	14243	8546	2976	1482	977	118	144
1978	14231	8017	3211	1612	1094	134	163
1979	14143	7482	3366	1763	1212	147	173
1980	14219	7023	3538	1967	1347	154	190
1981	14206	6518	3648	2185	1468	183	204
1982	14123	5967	3718	2395	1641	173	229

Source: Reports of Condition and Income

Note: Please see the Appendix for an explanation of these variables.

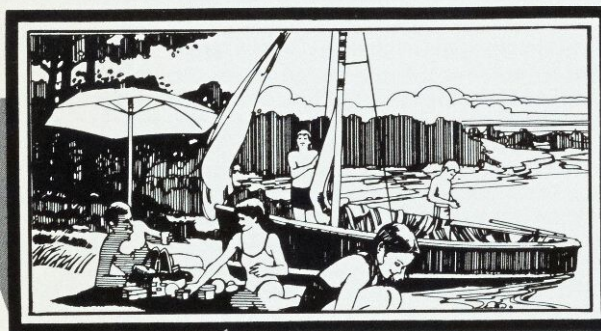


Services: Key to Current Stability and Future Growth



The Southeast's strong services industry should continue growing both in terms of jobs and profits, according to this analysis.

Yet enthusiasts may be expecting too much in anticipating that the industry can take up the slack left by cutbacks in manufacturing.



During the recent recession the terms "Sunbelt" and "services" often appeared together to describe the comparatively moderate impact of the economic downturn in certain areas of the country, such as central Florida, Atlanta and parts of Texas. Yet such conditions weren't enjoyed equally throughout the Southeast, as clearly shown in a recent issue of this publication.¹ The Sunbelt is a popular abstraction with connotations of rapid growth, prosperity and new jobs. It bears little relevance to many rural and industrial areas in Mississippi, Alabama, Tennessee and parts of Georgia. Is the concept of a service-based southeastern economy equally diffuse? Is it similarly devoid of meaning except in certain pockets of prosperity in this region?

Services' Share of the Southeastern Economy

In terms of jobs the largest service industries (see box) are trade, miscellaneous services and government; the smallest are finance, insurance and real estate (hereafter termed finance) and transportation (subsequently termed transportation and utilities). Chart 1 illustrates the distribution of jobs among the major services in the Southeast and in the United States. The Southeast accounts for 12.7 percent of the nation's jobs but 12.8 percent of U. S. service employment. Although the Southeast's total share of service employment is slightly greater than the national average—73.8 versus 73.4 percent—the distribution of services differs in several important ways. For example, government accounts for a relatively greater share of employment in the Southeast than in the nation—18.8 percent versus 17.6 percent; finance and miscellaneous services account for proportionately smaller shares—5.7 and 19.5 percent, respectively, than in the nation, where they comprise 6 and 21.2 percent.

Moreover, these differences appear even more extreme if we exclude Florida, which skews the region's average because of its large population and unique economic characteristics. Florida boasts almost one-third of the nonfarm jobs in the Southeast, and its distribution of

¹"The Southeast in 1983, Special Issue," *Economic Review*, February 1983. 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.

What Makes Up The Service Sector?

In economic terms, services are distinct from goods-producing activities, such as mining, farming, manufacturing, and construction, in that what is exchanged is usually intangible and often cannot be stored or reused. Transportation illustrates this distinction. A round-trip airline ticket entitles the bearer to be transported from Nashville to Mobile and back, and no more. A small jet enables its owner to fly many times and still retain a depreciated portion of the dollar amount originally paid. According to the U. S. government's standard industrial classification (or SIC), codes, as revised in 1972, the service sector includes high-asset, capital-intensive operations, such as airline, telephone and power companies, as well as personal and consumer services offered by individuals or households, such as "mom-and-pop" grocery stores.

The services sector includes five broad categories: (1) wholesale and retail trade; (2) transportation, communication, and public utilities; (3) finance, insurance and real estate; (4) miscellaneous services; and (5) government. The components of each category are fairly obvious, although it may not be readily apparent that transportation encompasses transportation of oil and natural gas through pipelines.

Miscellaneous services is the most heterogeneous category. It encompasses personal services, such as cleaning, gardening, and repairs; consumer services, such as recreation and health care, and business services, such as engineering, accounting, advertising, and law. This category also includes profit-based social services such as day-care centers and private, non-profit organizations.

Although government includes the majority of educational services, private education is classified under miscellaneous services. Certain states have slightly different taxonomic schemes. For example, in Tennessee local utilities tend to be public rather than privately owned and publicly regulated. Consequently, workers who in most states would be classified as transportation, communication and public utilities

employees are counted as government workers in Tennessee. SIC codes also do not discriminate according to the type of work done by individual employees: accountants employed by steel producers are classified as manufacturing workers. The Tennessee Valley Authority's large construction work force is included under the rubric of government rather than construction employment.

Many scholars studying the apparent structural economic shift from goods to services modify this broad definition of services in order to understand better the dynamics of this change. Hudson Institute futurist Herman Kahn distinguishes two broad service categories: the tertiary—transportation, finance, trade, and miscellaneous business services closely tied to production and the quarternary—consumer, nonprofit, and government services; these are consumed for their own sake or to support other services. He believes that this quarternary sector is likely to command the largest portion of the labor market in the 1980s and may act as a drag on the primary and secondary sectors. Victor Fuchs omits transportation, communication and public utilities from his research on services because of the close relationship between this category and the goods sector.* By reorganizing the above SIC codes according to their final output, Thomas Stanback has developed a three-part classification—consumer, producer, and public services. He predicts that future services growth will be strongest in producer services.** Sociologist Joachim Singelmann,+ in his investigation of seven industrial economies since 1920, maintains that the sectoral shift also entails secular decline of distributive and personal services that have been waning in importance while social and producer services have been rising.++ Some futurists identify "information" as the fourth sector of advanced economies. This growing sector is distinct from other services, such as many governmental functions, personal, and even some consumer services, in which rapid growth may have already passed its peak.

*See, e. g. Victor R. Fuchs, "Economic Growth and the Rise of Service Employment," Working Paper No. 486, National Bureau of Economic Research, June 1980. Fuchs contends that the inclusion of this sector would have made only a slight difference in his findings.

**Thomas M. Stanback, Jr., *Understanding the Service Economy: Employment, Productivity, and Location* (Baltimore: Johns Hopkins University Press, 1979) and Stanback *et al.*, *Services: The New Economy* (Totowa, N. J.: Allanheld, Osmun, and Co., 1981); in the latter Stanback

and his colleagues also use a classification scheme similar to Singelmann's.

+Joachim Singelmann, *Agriculture to Services: The Transformation of Industrial Employment* (Beverly Hills, California: Sage Publications, 1978).

++See Herman Kahn and B. Bruce-Briggs, *Things to Come: Thinking about the 70s and 80s* (New York: Macmillan, 1972), pp. 26, 224-5.

in the region. For example, Florida's financial sector is larger than those of other southeastern states. Last year this industry accounted for 7.5 percent of Florida's jobs but only 5.3 percent of Georgia's employment and less than 5 percent in Alabama, Louisiana, Mississippi and Tennessee. Miscellaneous services provide almost one-fourth of Florida's jobs but only 15.4 percent of Mississippi's nonfarm employment and less than the national norm (about one-fifth) of employment in the other southeastern states. Conversely, Florida's relatively small government sector understates the importance of public employment in the region. Government provides only 16.7 percent of Florida's

jobs but 22.1 percent of Alabama's, 19.8 percent of Georgia's, 19 percent of Louisiana's and 22.7 percent of Mississippi's.

Trade is relatively more important in the Southeast than in the United States but only in Florida and Georgia; in the remaining southeastern states it accounts for less than the national average of 22.9 percent of jobs. Transportation—the other category in which the Southeast outranks the United States in relative share—is distributed more evenly throughout the Southeast, yet it too is concentrated in three states—Florida, Georgia, and Louisiana. Atlanta's and Miami's importance as transportation hubs and Louisiana's pipelines account



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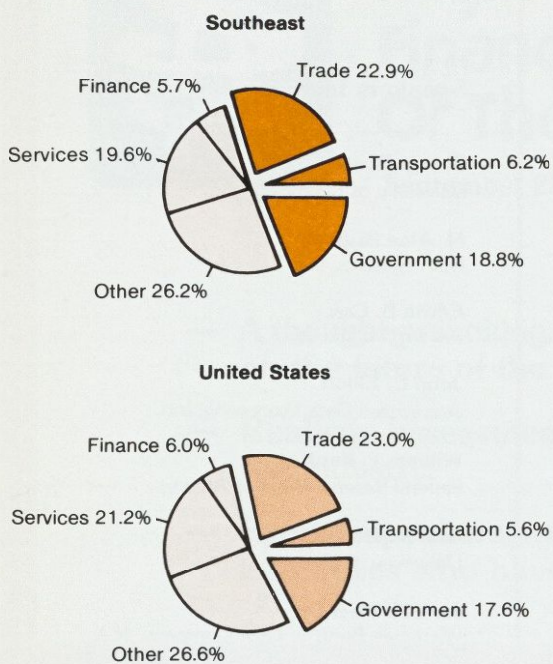
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Chart 1. 1982 Distribution of Employment



for the relatively large percentage of transportation jobs in these states: 6.1 percent in Florida, 6.6 percent in Georgia, and 8 percent in Louisiana.

Concentration ratios measure the degree of geographic over- or underrepresentation. Simply stated, these ratios, also termed "location quotients," compare a region's share of some economic variable, such as service jobs, with the share of that variable in another, usually larger, area. Concentration ratios of less than one indicate underrepresentation; those of more than one, overrepresentation. For example, if Florida has 40.5 percent of the Southeast's miscellaneous service jobs but only one-third of its total nonfarm employment, we can determine its degree of dependence on this sector by dividing 40.5 by 32.6. The result, 1.24, indicates that Florida has about 24 percent more miscellaneous service jobs than one would expect if the Southeast were perfectly homogeneous in its employment composition. Table 1 illustrates the extent to which southeastern states except Florida are underrepresented in most service jobs except government and transportation.

By another measure—the number of large service companies' headquarters—this pattern of concentration in certain states is repeated. Of **Fortune** magazine's 500 largest service corporations, the Southeast in 1982 claimed 8 percent, up from 3.3 percent of the top 300 counted by **Fortune** 10 years earlier. The region's share of service companies is higher than its share of top manufacturing firms: only about 4 percent of the **Fortune** 500 are located in the Southeast. These large service corporations tend to concentrate in Florida and Georgia, which together had almost two-thirds of the regional total yet slightly more than half the employment.² The location of large corporation headquarters is important to the service sector because they tend to include many service functions and to attract independent service companies.

Service Jobs Remain Concentrated in Large Cities

Service jobs are distributed unevenly in another way: they tend to be clustered around cities. As Tables 2 and 3 demonstrate, the standard metropolitan statistical areas (SMSAs) of the Southeast claim a disproportionate share of service jobs relative to their respective shares of state employment. It should be no surprise that cities such as Tallahassee and Gainesville, Florida and Baton Rouge, Louisiana enjoy high levels of government employment since they are state capitols or seats of large state universities. Similarly, we would expect seaports and distribution centers such as Memphis, Mobile, Savannah and New Orleans to have relatively high concentration ratios in transportation and trade. However, as Table 3 indicates, urban concentration of service employment extends beyond the particular specialization of certain cities.

Traditionally, services have been marketed at the local level. A shoe manufacturer can ship his products across the nation and even around the world if demand is sufficient. But a boot-black is restricted to the market he can reach physically. Not only personal but also most business services, such as those offered by service industries differs from most other states

²Computed by the Federal Reserve Bank of Atlanta from data in **Fortune**, June 13, 1983, pp. 152-175; May 2, 1983; pp. 226-254; July 1973, pp. 120-135.

Table 1. Employment Concentration Ratios by State and Major Service Sector

	Ala.	Fla.	Ga.	La.	Miss.	Tenn.
Trade	.86	1.33	.99	.97	.86	.92
Transportation	.86	1.01	1.98	1.32	.81	.77
Finance	.80	1.13	.95	.85	.72	.81
Service	.87	1.24	.88	.94	.82	.92
Government	1.16	.88	1.06	1.02	1.21	.94

Source: Calculated from data released by southeastern State Departments of Labor or Employment Security

lawyers, architects and merchants, historically have served a market defined primarily by the size of the surrounding community. Even the largest airlines concentrate their operations in hub cities: Delta in Atlanta, American in Dallas, United in Chicago. Each carrier schedules most of its origination, destination, or transfer flights along with ancillary facilities and staff, such as hangars and mechanics, at one major airport.

Export-base theory is the common economic explanation of the urban concentration of services. Simply stated, it holds that cities are not economically self-sufficient. They cannot raise enough food locally to support their populations, nor do most cities have the natural resources to sustain their local economies. Consequently, they must export to pay for the goods they cannot produce locally. Manufactured goods are one source of exports; services marketed to the surrounding region are another.³

A second explanation is designated by the term "agglomeration." Certain large cities, like New York, attract services because of their already high concentration of related economic activities. Stanback, for example, found a concentration ratio of 1.4 for producer services in 17 SMSAs with a population of two million or more. Daniels found a similar pattern in most

cities of Europe and Great Britain.⁴ This concept might explain why corporate headquarters, including research and development as well as finance, remain densely concentrated around New York City.⁵ The high degree of linkage among certain services, particularly law, accounting, banking and insurance, accounts for the historical tendency of such services to cluster in central business districts and in central cities, such as London, New York and Paris.

Finance is the most heavily concentrated service sector in the Southeast (Table 2); its concentration ratio is 1.21. Transportation and miscellaneous services also are urbanized disproportionately. With a concentration ratio of 0.97, government is underrepresented in the region's SMSAs. The probable explanation for this pattern is both demographic and political. Much government employment is in public elementary and secondary education, and teachers are distributed on the basis of school age population, not overall employment. The population of many southeastern states, particularly Mississippi, is younger and more rural than the national norm.⁶ Only one-fourth of Mississippi's residents live in cities of 50,000 or more; the share in other southeastern states ranges from 45.3 in Alabama to 52.3 in Louisiana.⁷ This

³John M. L. Gruenstein and Sally Guerra, "Can Services Sustain a Regional Economy?", *Business Review* (Federal Reserve Bank of Philadelphia), July-August 1981, pp. 15-24. They argue that a service-based urban economy is congruent with export-base theory because some services, such as those provided by higher educational institutions of the Northeast, are exported.

⁴Peter Daniels, *Service Industries: Growth and Location* (Cambridge: Cambridge University Press, 1982), pp. 37-42.

⁵In 1981, the share of jobs in New York City accounted for by finance was

13.3 percent, nearly as large as the 15.5 percent share contributed by manufacturing. Computed from *Employment and Earnings*, U. S. Department of Labor, Bureau of Labor Statistics (May 1982), p. 112.

⁶"Population Estimates and Projections," Series P-25, No. 913, U. S. Department of Commerce, Bureau of the Census, (May 1982), p. 2

⁷"Population Profile of the United States: 1981," Population Characteristics, Series P-20, No. 374, U. S. Department of Commerce, Bureau of the Census, September 1982, p. 12.

Table 2. SMSA Employment Concentration Ratios by Major Service Industry

SMSAs	Transportation	Trade	Finance	Services	Government
Southeast	1.13	1.10	1.21	1.14	0.97
Alabama	1.18	1.11	1.23	1.19	0.97
Florida	1.03	1.01	1.01	1.02	0.97
Georgia	1.20	1.09	1.21	1.19	0.95
Louisiana	0.99	1.06	1.20	1.13	0.95
Mississippi	1.37	1.19	1.89	1.38	1.02
Tennessee	1.19	1.10	1.29	1.11	1.06

Source: Calculated from data in **Employment and Earnings**, U. S. Department of Labor, Bureau of Labor Statistics (May 1982), pp 106-117.

distribution creates a larger demand for teachers in rural areas and boosts the importance of government employment outside cities.

Second, the South plays host to a disproportionate share of military bases, most of which are located outside SMSAs. (After the Civil War and Reconstruction, the Republican Party garnered virtually no support in the South and the region became solidly Democratic. As a result, southern Senators and Congressmen experienced less interparty turnover than their northern counterparts. The seniority system made it easier for them to become chairmen of important congressional committees. As such, they were positioned to influence decisions regarding the location of military bases as well as public works projects. Furthermore, the executive branch since the 1930s supported policies designed to eliminate the dramatic income differences between the South and other sections of the country.)

Table 2 shows that Mississippi's metropolitan areas are most overrepresented in their share of service employment, while Florida's are most nearly proportional. More than three-quarters of all Floridians live in cities of 50,000 or more, whereas only 61.4 percent of Americans live in

cities that size. Since Mississippi is one of the nation's most rural states and Florida is much more urban than its neighbors, one can speculate that, as the region develops economically and becomes more urbanized, southeastern cities' disproportionate share of service jobs will diminish.

Recent technological developments increase the probability of this sort of structural change because many service jobs now involve the exchange of information. Insurance companies no longer need to house records at a central location; computers and communications make it feasible to operate such facilities from remote locations away from high-rent central business districts. Although labor-intensive jobs still must be performed near population centers, suburbs and smaller cities near SMSAs have already drawn many service businesses as evidenced by the growth of commercial office space in the suburbs of Atlanta and other southeastern cities.⁸

The Growth Record of Services

Over the last decade, finance and transportation have constituted the fastest growing service industries; yet, because of their large bases, trade and miscellaneous services have

⁸Peter Daniels, *op. cit.*, maintains that in most western economies consumer services, particularly retail trade, follow population shifts to the suburbs; cost pressures and technological advances in communication

stimulate producer services to move out of central business districts, but integration constrains the distance of relocation, particularly among law, accounting, insurance, and banks.

Table 3. Concentration Ratios of Service Employment in Southeastern SMSAs

Alabama	1.10	Georgia	1.09
Birmingham	1.11	Albany	0.96
Huntsville	1.00	Atlanta	1.13
Mobile	1.08	Augusta	0.93
Montgomery	1.18	Columbus	0.96
Tuscaloosa	1.11	Macon	1.11
		Savannah	1.06
Florida	1.01	Louisiana	1.05
Bradenton	0.94	Alexandria	1.15
Daytona Beach	1.04	Baton Rouge	1.03
Fort Lauderdale	1.01	Lafayette	0.94
Fort Myers	1.03	Lake Charles	0.87
Gainesville	1.11	Monroe	1.06
Jacksonville	1.04	New Orleans	1.11
Lakeland	0.86	Shreveport	0.97
Melbourne	0.90		
Miami	1.02	Mississippi	
Orlando	1.01	Jackson	1.23
Panama City	1.04		
Pensacola	1.01	Tennessee	1.11
Sarasota	1.02	Chattanooga	1.01
Tallahassee	1.15	Knoxville	1.05
Tampa	0.99	Memphis	1.20
West Palm Beach	0.98	Nashville	1.10

Source: Calculated from data in **Employment and Earnings**, U.S. Department of Labor, Bureau of Labor Statistics (May 1982), pp. 106-117.

created more new jobs (Table 4). The southeastern job growth in most service industries is higher than the corresponding national rate. Moreover, with the exceptions of finance and social and professional services, this pattern prevails in all District states, not just Florida, Georgia or Louisiana. In the last few years, though, growth has slowed in most of the services (see Chart 2). In 1982 southeastern government employment declined slightly. Although services remain less vulnerable to economic downturns than manufacturing and construction, their rate of growth slows. Urquhart found that in the seven postwar recessions service employment slowed to an average 2.1 percent growth rate.⁹

Within this category, restaurants, food stores, health care, social services (including day-care centers) and various business services, including legal and other professional services, have enjoyed the highest and most consistent rates of job growth; personal services and general merchandise stores have had the poorest record (see Table 4). Health care and restaurants have created the most new jobs over the period. In terms of relative growth, miscellaneous services

enjoyed the largest increase in share, from 16 to 19 percent in the Southeast (see Table 5).

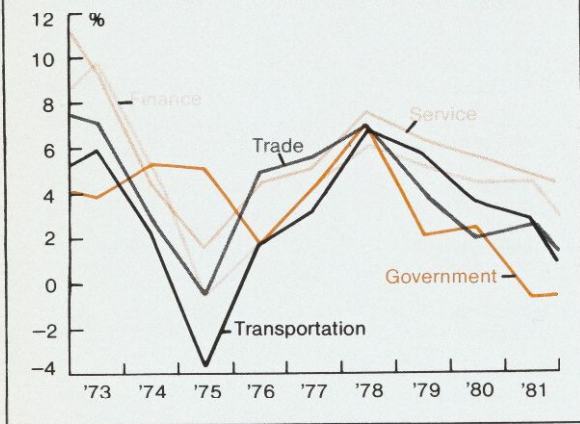
Is Job Growth Matched by Other Measures of Economic Performance?

Although service industries have proven an important source of jobs during the last decade, their economic performance is less impressive when measured in terms of output and income. Services accounted for about two-thirds of gross national product (GNP) but almost three-quarters of jobs in 1982. Since service markets are more local, it may be appropriate to exclude output generated by international trade and consider only gross domestic product (GDP). However, services constitute only 68.5 percent of GDP. Counting construction but not transportation, communication and public utilities, the postwar growth record of services is less rapid in terms of GNP share than of employment: from 1948 to 1978 the service sector's share of GNP rose from 53.6 percent to 57.1 percent, whereas its share of employment rose from 48 percent to 62.7 percent.¹⁰ Moreover, in terms

⁹Michael Urquhart, "The Services Industry: Is It Recession-Proof?" **Monthly Labor Review**, 104, 10 (October 1981), pp. 15.

¹⁰Lora S. Collins, "The Service Economy," **Across the Board**, November 1980, pp. 17-22.

**Chart 2. Southeast Service Employment
Annual Percent Change, 1973-1982**



of Gross Domestic Product, there has been little change in the distribution of goods and services since 1950.¹¹ A similar disparity pertains to profits, national income and personal income (see Chart 3). In general, transportation and finance account for a much larger share of the nation's output, profits and income than of jobs; miscellaneous services, trade, and government contribute a noticeably smaller share (see Chart 3).

Most of these measures are unavailable at the state or regional level because of sampling problems. (It would be costly to collect data from samples large enough to be valid at the state level.) The economic census reports receipts by state every five years, but it does not cover all the service sectors under study here. Furthermore, the most recent data are from 1977; data for the 1982 census are only now being collected. State sales tax receipts are subject to similar problems of comparability. Even growth is difficult to trace.

Available comparable data on personal income computed from the shares of personal income contributed by each service sector to the southeastern economy make it apparent that the national pattern is equally applicable to the Southeast: miscellaneous services, government and trade contribute a larger share of jobs than of personal income, even when transfer payments and other non-wage forms of income are

¹¹Fuchs, *op. cit.*

Table 4. Average Annual Percent Change and Net Increase in Service Employment, 1973-80*

Industry	S E	U.S.	Net Gain in S E 1973-80
Total Nonfarm Employment	2.8	2.1	1,516,416
Transportation & Utilities	2.5	2.4	89,041
Communications	1.1	1.9	10,606
Electricity and Gas	1.1	3.1	10,939
Other (primarily trans.)	2.0	2.5	60,942
Wholesale Trade	2.3	2.6	90,768
Retail Trade	2.7	2.8	310,722
General Merchandise	-1.5	-0.3	-30,328
Food Stores	4.0	3.3	68,679
Apparel Stores	1.6	1.2	12,439
Restaurants	7.5	6.4	211,351
Total Trade	2.6	2.8	401,490
Finance, Insur., R. E.	4.0	3.8	137,649
Insurance Carriers	4.3	2.7	31,967
Insurance Agents	5.4	4.8	17,219
Real Estate	1.7	2.9	12,325
Other	5.6	4.8	89,078
Services	5.7	5.4	608,467
Hotels	4.3	2.9	31,649
Personal	-0.2	-0.1	-2,594
Business	6.0	6.4	102,570
Auto Repair	4.6	4.5	18,805
Misc. Repairs	5.9	5.3	14,645
Amusements	5.2	5.2	31,947
Health	3.9	6.0	257,251
Legal	7.5	7.4	22,800
Education	2.8	4.8	17,873
Social Services	9.0	10.1	43,924
Nonprofit Orgs.	5.0	3.4	35,895
Misc. Professional	6.9	7.8	31,844
Government	3.9	1.6	534,600

Source: Computed from data in annual editions of **County Business Patterns**, U.S. Department of Commerce, Bureau of Census, 1973-80; government employment is computed from releases of State and U.S. Labor Departments.

excluded (see Table 6). SMSA concentration ratios for service receipts follow a pattern much like that of service employment. Mississippi's metropolitan areas and Louisiana's are overrepresented more than other southeastern cities (see Table 7). Florida's (and Louisiana's) SMSAs are least overrepresented although not in educational and social services.

One partial measure can be made by comparing the Southeast's leading service companies with other **Fortune** 500 service companies. As illustrated in Table 8, large southeastern service companies tend to perform below the **Fortune** average for their respective industry. Two exceptions are transportation firms' operating revenues and diversified services' net income, which are above average. One reason sales and net income are less than

Table 5. Relative Change in Service-Employment, 1973-82
(percent)

	Southeast		Percent Change	United States		Percent Change
	1973	1982		1973	1982	
Transportation	6.3	6.2	-0.1	6.1	5.6	(-0.5)
Trade	22.6	23.6	1.0	21.6	22.9	1.3
Finance	5.2	5.7	0.5	5.3	6.0	0.7
Services	16.2	19.6	3.4	16.7	21.2	4.5
Government	18.3	18.8	0.5	17.9	17.6	(-0.3)
Total Services	68.6	73.8	5.3	67.7	73.3	5.7

the **Fortune** mean is that a few giants skew the average. Southeastern companies' profit margin ranks above average except in transportation and utilities. Another positive sign is that the majority of southeastern firms ranked above the median in the ten year growth rate in earnings per share. Judging by these indicators, large service companies in the Southeast appear to be growing rapidly and providing a return (on revenues) that compares favorably with their counterparts elsewhere.

What Factors Underlie This Record of Performance?

Explanations for the growth of services industries come from a variety of disciplines and professions, ranging from economics and sociology to geography and journalism.¹² One early and straightforward economic explanation is based on Christian Engel's law of income elasticity: as household income increases, the proportionate amount spent on necessities such as food diminishes. In the 1930s and 1940s Colin Clark and Allen G. B. Fisher, working independently, applied this nineteenth century microeconomic principle to the economy in aggregate to explain the economic shift from

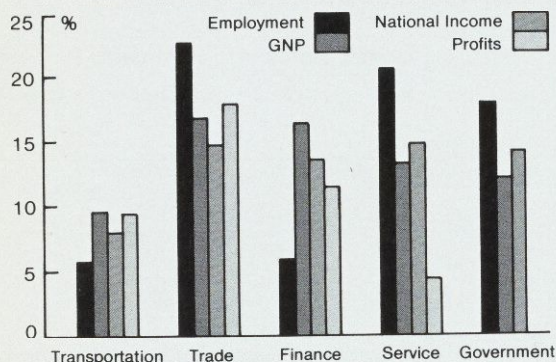
agriculture and extraction (the primary sector) to manufacturing (the secondary sector). To some extent the more recent shift to services (the tertiary sector) is attributable to similar phenomena. As family income rises, a larger share of expenditures is allocated for services: not only personal services such as dry cleaning but a variety of consumer services—restaurants, travel, recreation, education, and health care.

This explanation can be applied as well to the increase in public services. Some social scientists maintain that rising and widespread affluence has effected a shift from material to nonmaterial values; we increasingly prefer higher education, a cleaner outdoor environment, a less hazardous work-place and safer products over increases in individual material wealth; we also want a more egalitarian distribution of material values for women, blacks and ethnic minorities. Thus, insurance and pension services grew in importance throughout the postwar period as employees sought benefits to increase their security in sickness and during retirement, and demand for recreational services grew in response to increased leisure time that workers sought as a supplement to wage increases. This value shift also engendered rapid growth in public services, including regulation to achieve a healthier work and outdoor environment,

¹²Sociologist Daniel Bell was one of the first to bring attention to this structural macroeconomic change. See Bell, **The Coming of Post-Industrial Society: A Venture in Social Forecasting** (New York: Basic Books, 1973), pp. 123-164. Social critic Alvin Toffler has extended public

awareness of this economic change as well as related political, educational and social changes. See e. g., his excerpt in **Growth Industries in the 1980s; Proceedings of a Conference Sponsored by the Federal Reserve Bank of Atlanta** Westport, Connecticut: Greenwood Press, (forthcoming).

Chart 3. Services Industries' Share of GNP, National Income and Profits



Source: Computed from data in **Survey of Current Business**, U. S. Department of Commerce, Bureau of Economic Analysis (July 1982), pp. 78, 79, 93.

Table 6. 1982 Services Share of Personal Income and Employment

Sector	Percent of Nonfarm Earnings		Percent of Jobs	
	S.E.	U.S.	S.E.	U. S.
Trade	18.1	16.6	23.6	22.9
Transportation	8.9	7.9	6.2	5.6
Finance	5.7	6.0	5.7	6.0
Services	17.8	18.5	19.5	21.2
Government	17.9	16.6	18.8	17.6
Total Services	68.4	65.6	73.8	73.4

Source: Computed from data released quarterly by Bureau of Economic Analysis, U. S. Department of Commerce and **Survey of Current Business**, (August 1982) pp. 62-71.

and in related business and professional services, such as health care and law.

However, other factors have also contributed to the growth of the service sector. Demographic patterns account for some of the rise in public sector employment, particularly education. The postwar "baby boom" created a bulge in the population distribution. As this age group passed through elementary and secondary school, the demand for teachers grew. Moreover, in the last two to three decades the marketplace for American products has grown from national to worldwide proportions. Increasing market size has rendered larger firms more practical. Economies of scale entail more specialization and division of labor but also more coordination. Consequently, accounting, finance, advertising, and other business services have grown rapidly both inside and outside companies.¹³ In the goods sector the proportion of service jobs has risen from 19 percent in 1942 to 32 percent in 1982.¹⁴

Fuchs denies that the Clark-Fisher hypothesis accounts for the shift from manufacturing to services.¹⁵ He argues that increases in the female participation rate may account for one-fourth of the annual rate of increase in services since 1950.¹⁶ As more women work, activities such as laundry and food preparation that

traditionally have been provided within the household are purchased in the marketplace. Using Bureau of Labor Statistics (BLS) data on consumer expenditures, Fuchs found that when wives work, the share of the household budget allotted to services rose by 10 percent and the share allotted to goods fell by 3-4 percent. Moreover, services represent a primary source of jobs for female entrants into the labor force. Women comprise a larger percentage of employees in almost all service industries except transportation and utilities.

Fuchs also addresses the apparent anomaly between the growth of services in terms of employment and in other measures such as output and income. More units of labor are required to produce an additional dollar's worth of services than of manufactured products or foodstuffs. Consequently, service industries add jobs faster than they add revenues, profits or wages. Several factors explain the productivity lag of services. Substituting capital for labor, the primary method of increasing productivity, is not feasible in many personal services. Eating at a restaurant cannot be automated beyond certain limits without undermining the very reasons consumers choose to dine out rather than cook a meal, or eat a ready-made one, at home. Many services, ranging from haircuts to concerts, require a fairly fixed period of time.

¹³Stanback, *et al*, 1981, pp. 12-13.

¹⁴Alfred Malabre, Jr., "Service Jobs Keep Expanding in Recession, Make Up Ever Larger Share of Work Force," **Wall Street Journal**, January 15,

1982, p. 44.

¹⁵Fuchs, *op. cit.*, p. 16.

¹⁶*Ibid.*, pp. 20-25.

Table 7. SMSA Receipts Concentration Ratios by State and Selected Services

State	Selected Services				
Alabama	1.19	Hotels	1.28	Dental	1.27
Florida	1.17	Personal Services	1.15	Business Services	1.32
Georgia	1.22	Auto Repairs	1.23	Legal	1.32
Louisiana	1.08	Miscellaneous Repairs	1.17	Engineering	1.38
Mississippi	2.53	Recreation	1.36	Education	1.28
Tennessee	1.26	Health	1.22	Social Services	1.09

Sources: Computed from receipts data in 1977 Census of Service Industries, Geographics Area Series, U. S. Department of Commerce, Bureau of Census and from SMSA employment in **Supplement to Employment and Earnings, States and Areas Data for 1977-81**, U. S. Department of Labor, Bureau of Labor Statistics, September 1982.

Some observers contest this view.¹⁷ They maintain that eventually technological changes can be applied to services. Until fairly recently, for example, the demand for entertainment— theater and music—was satisfied through the services sector by attending plays and concerts. Since each play could reach only local audiences, aggregate demand for this type of recreation could support a relatively large force of actors and related workers. The advent of phonographs, movies and television satisfied demand for this type of entertainment through the manufacturing sector. By purchasing stereos, movie tickets and TVs the modern consumer satisfies his demand for entertainment; this demand supports an occupational mix more heavily weighted toward producers of equipment. Those actually providing the entertainment service constitute a relatively smaller portion of this segment of the labor force.

Another explanation for lagging productivity in services pertains to measurement. The BLS measures productivity for 16 service industries that account for about one-third of all service employment. These 16 are drawn from transportation, communication, public utilities, retail trade, lodgings and laundry. More specifically, these measures account for about three-fifths of transportation jobs, four-fifths of communi-

cation jobs, but only 13 percent of business and professional services. The BLS is developing measures for banking, insurance, and hospitals. However, the Bureau expects work on medical and educational services to proceed slowly because of conceptual problems. The intrinsic problem is exemplified most clearly in the case of government. Because most government services are not "sold," there is no independent measure of output against which to measure change in labor input.¹⁸

Among those service industries for which productivity measures exist, some exhibit high growth rates. Not surprisingly, two capital-intensive services, telephones and air transportation, boast the best records. From 1973-1980 their productivity increases averaged 7 percent and 4.3 percent respectively, well above average productivity changes in this period. The next highest was gasoline service stations, with an annual average growth rate of 3.1 percent. Computers may provide the basis for expanded productivity growth in other service industries, particularly business services. For example, in engineering and architecture, computer-aided design renders it economically feasible to create, test, and alter a much larger number of designs and plans because computers can perform such tasks as drawing and calculating stress

¹⁷E.g., Jonathan Gershuny, **After Industrial Society? The Emerging Self-Service Economy** (Atlantic Highlands, N. J.: Humanities Press, 1978).

¹⁸Jerome A. Mark, "Measuring Productivity in the Services," **Monthly Labor Review**, (June 1982), pp. 3-8.

Table 8. Largest Southeastern Service Companies

Company	Sales \$ mil.	Net Income \$ mil.	Profit Margin Net Income/Sales %	Earnings Per Share Compound Annual Avg. Growth Rate 1972-82*
Diversified Services				
Hospital Corp. of America, Nashville	2,976.9	171.9	5.8	25.62
Malone & Hyde, Memphis	2,192.9	27.8	1.3	12.75
Ryder System, Miami	2,075.9	82.6	4.0	12.89
Genuine Parts, Atlanta	1,936.5	100.2	5.2	13.96
Holiday Inns, Memphis	1,755.3	76.0	4.3	3.46
Ocean Drilling & Exploration, New Orleans	979.6	191.9	19.6	27.38
Blount, Montgomery	769.3	12.4	1.6	14.22
Rollins, Atlanta	526.5	46.0	8.7	13.02
Southeastern Average	1,651.4	89.3	5.4	
Average of Top 100	1,905.4	61.5	3.2	
Retail Trade				
Winn-Dixie Stores, Jacksonville	6,764.5	103.5	1.5	10.87
Publix Super Markets, Lakeland	2,506.9	46.8	1.9	*
Jack Eckerd, Clearwater	2,080.2	70.7	3.4	10.04
Service Merchandise, Nashville	1,195.3	31.6	2.6	34.93
Southeastern Average	3,136.7	63.1	2.0	
Average of Top 50	4,923.2	88.7	1.8	
Transportation**				
Eastern Air Lines, Miami	3,769.2	(74.9)	—	*
Delta Air Lines, Atlanta	3,617.5	20.8	0.6	(7.22)
Federal Express, Memphis	803.9	78.4	9.8	*
Tidewater, New Orleans	466.3	71.5	15.3	21.87
Southeast Average	2,164.3		23.9	
Average of Top 50	1,556.8		46.0	
Utilities***				
Southern Company, Atlanta	12,301.2	472.3	13.5	2.39
Middle South Utilities, New Orleans	10,364.7	310.6	12.5	1.64
Florida Power & Light, Miami	6,850.6	301.1	13.6	7.39
Continental Telecom, Atlanta	3,864.6	150.5	14.1	3.79
Sonat, Birmingham	3,139.5	204.6	18.0	15.65
Southeastern Average	7,304.1	287.8	3.9	
Average of Top 50	8,964.0	404.5	4.5	

Company	Sales \$ mil.	Net Income \$ mil.	Profit Margin Net Income/Sales %	Earnings Per Share Compound Annual Avg. Growth Rate 1972-82*
Commercial Banking***				
Southeast Banking Corp., Miami	7,274.3	52.6	12.2	5.76
Barnett Banks of Florida, Jacksonville	6,932.1	56.8	14.6	9.71
Citizens & Southern Georgia Corp., Atlanta	6,004.6	50.0	15.1	4.46
Sun Banks of Florida, Orlando	5,004.	34.2	11.2	5.90
Trust Company of Georgia, Atlanta	4,510.6	52.5	20.6	15.33
First Atlanta Corp., Atlanta	4,480.0	38.4	14.8	12.42
Florida National Banks of Florida, Jacksonville	3,498.5	21.3	7.9	5.78
First Tennessee National Corp., Memphis	3,392.1	26.8	12.9	7.25
AmSouth Bancorp., Birmingham	3,255.5	31.9	13.2	9.69
Southeastern Average	4,928.0	40.5	13.6	
Average of Top 100	13,558.9	74.6	12.0	
Diversified Finance***				
Freedom Savings & Loan Association, Tampa	1,320.4	(7.4)	*	*
Citizens Savings Financial, Miami	1,302.7	1.6	5.6	*
American Family, Columbus	1,104.1	24.7	11.7	8.96
First City Federal Savings & Loan Association, Bradenton	795.3	(3.9)	*	*
Naples Federal Savings & Loan Association, Naples	783.7	1.7	3.4	*
Gulf United, Jacksonville	3,248.4	101.0	15.8	6.04
Torchmark, Birmingham	3,036.9	79.4	12.3	17.83
American Savings & Loan Association of Florida, Miami	2,305.6	(13.2)	*	*
Southeastern Average	1,737.1	23.0	10.8	
Average of Top 100	5,513.4	52.6	10.0	
Insurance***				
National Life & Accident, Nashville	3,147.6	243.2	—	—
Liberty National, Birmingham	1,752.6	90.3	—	—
Southeast Average	2,450.1	166.7	—	—
Average of Top 50	8,736.9	600.0		

* Not computed if loss occurred in 1972 or 1982

** Ranked by operating revenues; margin measured by net income as percent of operating revenues.

*** Ranked by assets, margin for utilities, banks, and diversified finance measured by net income as percent of equity

Source: **Fortune** (June 13, 1983), pp. 152-173.

factors much more quickly than a staff of artists, draftsmen and clerks.

Application of scale economies and modern management techniques provides another potential source of productivity growth in the services sector. In health care, for instance, soaring costs have given rise to hospital management corporations, such as Hospital Corporation of America and Humana. These "for-profit" companies attempt to operate hospitals in a cost-efficient and hence more profitable manner. Although only 1,000 of the nation's 7,000 hospitals now operate for profit, investor-owned hospitals represent the fastest growing sector of the health care industry.¹⁹ These are concentrated in the South. In the Northeast, attitudes toward health care are influenced by a tradition of philanthropy. In the South, population expansion and economic growth have combined with a popular attitude more favorable toward profit-based health care to foster rapid growth of such institutions.²⁰ Whatever the reason, this segment of the health care industry is growing rapidly.

What Are the Implications for the Southeast?

The services' relatively poor performance in regard to GNP and other output measures of the service sector augurs poorly for the future of areas dependent on these industries. Many service businesses generate too low a level of profits to finance their own future growth; even their borrowing capacity is constrained by low profitability. Because the Southeast traditionally has been considered a capital importer, it finds the problem of funding economic expansion of particular concern. However, the Southeast's edge in transportation and Florida's strength in finance are promising exceptions since both of these industries have strong records of profitability and income, notwithstanding current financial problems in the airline industry.

Second, the service sector is too concentrated in cities and in certain states to absorb, without some dislocation, the slack in labor markets occurring as a result of foreign competition in textiles and apparel. The mills closing permanently are often in rural counties of Tennessee,

Georgia and Mississippi, not near service-oriented cities, like Atlanta, or urbanized states, like Florida.

The service industry least concentrated in urban areas is government, and job growth in the public sector is regarded widely as entering a period of secular decline. It is difficult to determine whether values have actually begun to reverse from the 1970s, but reducing the federal government's role has been a recurring presidential theme for almost a decade under both Republican and Democratic administrations. Furthermore, it is likely that rapid growth in government probably is over for the foreseeable future if for no other reason than saturation: both benefits and regulations have been implemented about as broadly as possible. The related level of government employment may not decline dramatically, but it is unlikely to increase substantially until another major change in political values occurs. Recent increases in federal defense spending have done little to alter personnel levels at military installations; their effect in the Southeast has been felt primarily in manufacturing, especially in high-technology electronics production.

Third, even if displaced workers relocate, the service industries they are most likely to enter are characterized by low-skilled, low-paying, part-time jobs—restaurants, hotels, grocery stores and other retail trade establishments. In 1982, hourly earnings averaged \$6.22 in trade and \$6.91 in services compared with \$8.50 in manufacturing and \$7.67 in the private sector generally. Because a relatively large portion of workers in textile and apparel mills are women, and since women are overrepresented in the many service industries, such a transition is more likely than one leading into more male-dominated service industries. Although figures are not available at the state level, nationally women are overrepresented in the service sector. Women held 43.5 percent of all jobs in 1982 but 50.5 percent of all retail trade jobs, 59.4 percent of service jobs and 47.9 percent of government jobs. The only exceptions to this pattern are in transportation and utilities, wholesale trade retail food stores, repairs, recreation, and business and professional services,

¹⁹U. S. Department of Commerce, Bureau of Industrial Economics, 1983 U. S. Industrial Outlook, January 1983, p. 52-7.

²⁰Thomas W. Mader "Health Service Markets," Research Report 647, SRI International, February 1981, p. 10.

in which the proportion of women is less than or equal to their proportion of total employment. The faster growing, higher wage service industries, such as transportation, accounting, and engineering require more advanced educational training and higher skill levels than textile and apparel production workers typically possess, and they have not absorbed women entrants to the labor force as quickly as other service industries. Such a structural change in the composition of southeastern employment will do little to narrow the gap in personal income between this region and the nation. Except in more prosperous Florida, per capita personal income in southeastern states ranges from 71 percent of the United States norm in Mississippi to 91 percent in Louisiana.²¹

Fourth, there is at least theoretical reason to believe services grow in tandem with expansion of goods production. Since most services cannot be exported, their prosperity cannot be sustained without strength in the local economy's goods sector.²² Thus, areas with declining or weak industrial sectors cannot simply substitute service jobs for manufacturing jobs. Employment trends in Tennessee support this argument. The past two recessions have affected that highly industrial state severely because Tennessee's industries are oriented toward housing and autos and hence quite credit sensitive. In this economic environment trade employment has actually declined, while it has continued to grow or at least hold steady in other regions. A similar pattern obtains in Tennessee's finance industry, which elsewhere is a rapidly growing job sector.

Fortunately for the Southeast, some services can be exported. Miami has emerged as an important center of international finance and trade. Tourism provides not only as much as 17 percent of Florida's jobs but more than \$18 billion in expenditures and almost \$1 billion in tax revenues derived largely from nonresident visitors.²³ In Atlanta a modern airport and

extensive meeting, exhibition and lodging facilities have created a convention industry that attracts a nationwide market and provides employment for an estimated 81,000 people.²⁴ One indication of its economic impact is that the five major downtown hotels and the two trade marts accounted for 14 percent of the total property tax collected in Atlanta in 1981.²⁵ Of course, tourism cannot be developed out of nothing, but other areas of the Southeast, such as Tennessee, have learned to market their natural attractions or to develop commercial attractions to benefit from the large volume of pass-through traffic destined for Florida. The state of Mississippi has appropriated \$4 million to enable its tourist industry to take advantage of the 1984 World Exposition in neighboring Louisiana.²⁶

Yet problems of excess supply threaten to dampen the area's convention growth. Many cities, such as Washington, D. C. and Knoxville, Tennessee, have enlarged their convention facilities or opened new ones. Established southeastern convention centers, such as Miami Beach, Atlanta and New Orleans, face increasing competition. The number of hotel rooms in Atlanta, Orlando and other cities has been growing rapidly and should nearly double in some markets in the next three years. The result is likely to be lower occupancy rates during the adjustment period despite improved economic conditions.

In the longer term, technological changes should increase the likelihood of greater dispersion of services, especially those based on exchange of information and thus amenable to computer applications. Still, the rapid growth of commercial office space along the perimeter of Atlanta and other large cities indicates that suburbs, not remote rural counties, are taking the lead in attracting such operations. Moreover, these same technological changes may accelerate the substitution of capital for labor and hence diminish employment growth in services.

²¹Calculated from data in **Survey of Current Business**, (August 1982), pp. 55 and 57.

²²Exponents of this view include: William H. Miernyk, "The Changing Structure of the Southern Economy," **The Economics of Southern Growth**, edited by E. Blaine Liner and Lawrence K. Lynch (Research Triangle, N. C.: Southern Growth Policies Board, 1977), pp. 35-63; Lawrence Falk and Adam Broner, "Specialization in Service Industry Employment as a State Policy," **Growth and Change**, 11, 4 (October 1980), pp. 18-23; and Stanback, *op. cit.*, 1979, pp. 88 ff. Falk and Broner contend that service employment in the South grew more rapidly than elsewhere because of rapid growth in the working age population,

especially through migration; consequently, if this growth reaches a plateau, growth in service jobs should also taper. Miernyk found a weakened relationship between personal income and employment composition between 1940 and 1975 and concluded that a saturation is occurring in the shift from primary to secondary and tertiary sectors.

²³Figures calculated from Florida Visitor Studies, 1981, Florida Division of Tourism, Department of Commerce annual report.

²⁴Atlanta Convention and Visitors Bureau.

²⁵Research Atlanta, "The Convention Industry in Atlanta," September 16, 1982, p. 13.

²⁶Telephone conversation with Mississippi Office of Tourism.

Automated tellers may reduce the need for staff and for branch offices in banks, for instance. Electronic coding and advances in cable television and other forms of telecommunications may eliminate jobs in retail trade.

The Outlook for Southeastern Services

Which areas and sectors are likely to enjoy the most growth? In addition to transportation and tourism, discussed above, consumer services—particularly restaurants, food stores and health care—and producer services, including business and professional services and transportation, seem likely to grow the fastest.

Because of the large size of the trade sector, even a low employment growth rate will produce a comparatively large absolute increase in jobs. Demographics favor growth on the output side: the baby-boom generation is now in its mid-30s and at a peak period of spending for its own children, housing and entertainment. However, families are smaller, and the current disinflationary environment may encourage savings more than spending, at least for non-food items. The Commerce Department predicts only a 2 percent compound annual rate of growth in consumer sales versus a 2.3 percent yearly increase in real disposable income over the next five years. Southeastern states with high immigration rates, such as Florida, should do better because population growth, especially migration-related growth, is closely tied to increasing retail sales. Certain types of retail outlets should also do better, though. For example in 1983, the Commerce Department expects a 9 percent increase in current dollar sales of eating and drinking establishments over 1982 levels. Since trade is "overrepresented" in the Southeast, this projection is of particular regional significance.²⁷

Aside from retail trade, health care may provide the greatest number of new jobs. Future increases in health care appear less likely to come through extension of coverage of third-party and government-financed insurance than through aging of the population. This trend is significant to the Southeast for several reasons.

The region's attractiveness to retirees should give certain states, particularly Florida, a disproportionate share of this age group.²⁸ Second, the South's concentration of for-profit hospitals bodes well for the health care industry's future in the region. If health care costs continue to rise more rapidly than the rate of inflation, pressure to control costs should increase. Consequently, this sector is likely to enjoy relative growth even as public and non-profit health care facilities wane.²⁹ Such companies hold the potential for higher profits than most service businesses and hence for financing more economic growth. Of the nation's 50 leading diversified service companies, *Fortune* rated southern-based Humana—which ranked 32nd in terms of sales—the fastest-growing (44 percent annual average rate since 1971) in terms of earnings per share.³⁰

Summing up, the outlook for services is tied closely to developments in high technology, particularly in changes relating to computers and communications. Although employment growth may slow, greater productivity that high technology promises to bring to many services should raise income and profits in this sector, which in turn should generate a higher level of growth. Moreover, growth of high technology in the Southeast will stimulate demand for business services to manage the fast growing revenues of such firms, consumer services which high-paid engineers and technicians will seek, and public services, particularly education to upgrade local labor force skills and transportation.

Despite arguments that services cannot prosper independently of growth in the goods sector, the outlook for services in the Southeast seems positive both in terms of jobs and profits. Enough economic growth should be generated by population expansion especially through migration, and by a number of stronger manufacturing and services industries to increase income at both the household and regional level and to foster continuing growth in services in most southeastern states.

—Bobbie H. McCrackin

²⁷U. S. Department of Commerce, Bureau of Industrial Economics, 1983 *U. S. Industrial Outlook* January 1983, pp. 48-3 and 48-9.

²⁸According to Mader, *op. cit.*, p. 4, the oldest quartile of the population consumes almost half of the health care.

²⁹Mader *op. cit.*, p. 6, projects a 16.6 percent annual average growth rate in demand for profit-based health services.

³⁰Mary Greenebaum, "Winners Among the Service-Company Stocks," *Fortune*, July 12, 1982, pp. 149, 152.

New Investment Powers for S&Ls: Diversification or Specialization?

Fears that S&Ls will overextend themselves in offering new services and prices seem unfounded. While the new powers may be important to S&Ls' long-term viability, basic management expertise is likely to be the real key for all financial institutions.

Will the broader powers granted to savings and loan associations in 1980 and 1982 be the answer to S&Ls' recent earnings problems? Or will those new powers entice S&L managers to rush into unfamiliar territory too soon? Is diversification necessarily an advantage for any financial institution? Or might there be good reasons to remain specialized? As deregulation broadens the powers of more and more financial institutions, research on how financial institutions behave in such situations takes on important implications.

As far back as the 1971 Hunt Commission Report and its successor, the FINE study, financial experts have argued persuasively that the long-run viability of S&Ls hinged on their ability to expand their powers. They saw diversification on the asset side of the balance sheet as the key to unlocking restrictions on deposit rate ceilings and to bringing severe imbalances under control.

Despite this foresight, however, it was not until passage of the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA) that a significant break occurred. This act expanded the array of services S&Ls could provide to consumers and provided for the phase-out of deposit rate ceilings by 1986. Unfortunately for many S&Ls, however, the damage caused by inflation and high interest rates, binding rate ceilings and limited asset portfolio flexibility already had created a crisis for the industry—a crisis that could be resolved at reasonable cost only through a drop in interest rates.

In this atmosphere it was widely recognized that even further portfolio diversification permitting S&Ls to provide services to commercial entities, while necessary to deal with thrifts long-run problems, was unlikely to offer much immediate help to those with severely eroded net



worth and large earnings losses. Nevertheless, significant portfolio diversification proved to be a prominent feature of Congress's response to the thrift crisis in the compromise Garn-St Germain Depository Institutions Act of 1982.

Interestingly, however, what initially appeared to be an inadequate response to the thrift problem may take on a different light if interest rates remain at the lower levels prevailing recently. If interest rates remain low, then the short-run earnings pressure on thrifts should abate, enabling them once again to show positive earnings. If this happens, the strategic question facing S&Ls is how to adapt to liberalized asset and liability powers, including the newly authorized accounts designed to let them compete with money market mutual funds. More specifically, the question for an S&L is whether to become completely diversified like a commercial bank or to remain a specialized mortgage lender.

This article will review the performance of state-chartered thrifts with broadened asset and liability powers and will discuss recent research on the performance of a sample of commercial banks that chose to specialize in real estate lending. The study suggests that fears that S&Ls will rush out and overextend themselves in offering new services and in their pricing policies seem unfounded. More importantly, it implies that S&Ls can continue to be profitable without becoming indistinguishable from commercial banks. As for the real estate-oriented commercial banks, the evidence suggests that their profit performance is associated with the more favorable costs of funds rather than with their ability to diversify. The article concludes with some observations on how S&Ls might take advantage of their broader powers.

Recent Legislative Changes

Under DIDMCA, federal S&Ls received authority in 1980 to offer transaction accounts to individuals in the form of NOW accounts (Table 1). The 1982 Garn-St Germain Act granted federal S&Ls the authority to offer demand deposits not only to individuals but also, for the first time, to corporations in connection with loan arrangements. S&Ls also were permitted to provide NOW accounts to governmental units.

Under the 1980 act, asset diversification was limited both in terms of the range of permissible investments and also by the impositions of

quantitative limits. For example, commercial real estate lending was restricted to 20 percent of assets, as were the combined aggregate holdings of consumer loans, commercial paper and debt securities. (Many forms of consumer credit authorized by the 1980 act were not subject to quantitative limits. These included credit card debt and overdraft and line of credit incident to NOW accounts. Other forms of consumer credit, such as home improvement loans, also were free from the 30 percent limitation.)¹

The 1982 act relaxed the quantitative restrictions from 20 percent to 40 percent and broadened the array of permissible investments to include time and savings deposits of other associations, and, most importantly, commercial loans. This latter provision, together with the granting of commercial demand deposit powers (in connection with loan relationships), permits S&Ls to expand for the first time into the corporate segment of the financial service industry. It thus adds a whole new dimension to S&L diversification strategy. However, the 1982 act restricts corporate lending to 5 percent of S&L assets until 1983 and to 10 percent thereafter.

Most importantly, however, neither the 1980 DIDMCA nor the 1982 Garn-St Germain legislation comes to grips directly with a most important disincentive to S&L diversification. That is the provision in federal tax laws allowing S&Ls to add up to 40 percent of taxable income to bad debt reserves tax free if up to 82 percent of their assets are held in qualifying form.² With over two-thirds of S&Ls experiencing losses, this feature has been unimportant recently. However, should S&Ls return to a positive earning position, the net pre-tax return on non-qualifying assets would have to be more than 52 percent greater than on qualifying assets before an S&L would be encouraged to diversify from real estate lending (i.e. maintaining qualifying assets at 82 percent) into other, non-qualifying assets.³ Clearly, such differentials have been rare (at least for acceptable risks) and become even less likely if interest rates should continue to fall and then stabilize at lower levels.

¹ I am indebted to Marshall Kaplan for pointing out several misinterpretations of the 1980 and 1982 acts in an earlier draft of this paper. Gillian Garcia also pointed out some of these same problems.

² The 40 percent deduction is reduced by 3/4 of a percentage point for each percentage point that qualifying assets fall below 82 percent for S&Ls (72 percent for MSBs). No deduction is permitted below 60 percent.

³ Treasury Department (1980). The report notes that, depending upon costs and market conditions, gross returns may need to be only 5 percent greater to generate a net return 52 percent greater. The required return, however, increases for each percentage point qualified assets fall below 82 percent.

Table 1. Changes in S&L Assets and Liability Powers Resulting from Recent Legislative Actions

<u>Liability Powers</u>	
1. Nationwide NOW Accounts for a. individuals and not-for-profit organizations b. governmental units	DIDMCA-1980 Garn-St Germain 1982
2. Federal S&Ls may offer demand deposits to persons or organizations that have established a "business, corporate, commercial or agricultural loan relationship with the association"	Garn-St Germain 1982
3. Authorizes new accounts to compete with money market mutual funds Garn-St Germain (11/15/82) indicated that effective 12/14/82 one account would have a \$2500 minimum balance, no interest rate ceiling, an option to guarantee a fixed rate for one month, limited check writing facilities, and deposit insurance. A second account was authorized effective 1/5/83 identical to the 12/14/82 account but with unlimited transaction facilities. The account was subject to the reserve requirements on transaction accounts.	Garn-St Germain 1982
4. Authorizes establishment of Remote Service Units	DIDMCA-1980
<u>Asset Powers</u>	
1. Expands 20% limit of DIDMCA to 40% of assets that may be invested in commercial real estate loans	Garn-St Germain 1982
2. Up to 20% limit of assets may be invested in combination of commercial paper debt securities, and consumer loans	DIDMCA-1980
3. Expands limit in DIDMCA on consumer loans (including inventory and floor plan loans) from 20% to 30% of assets	Garn-St Germain 1980
4. May issue credit cards	DIDMCA-1980
5. May offer overdraft loans on any transaction account	Garn-St Germain 1982
6. Permits investment in time and savings deposits of other associations	Garn-St Germain 1982
7. Limited investment in state and local obligations of any one issuer to 10% of associations's capital and surplus. Total investment in general obligations is not limited.	Garn-St Germain 1982
8. May make commercial loans up to 5% of assets until December 31, 1983 and up to 10% thereafter. May be direct loans or participations	Garn-St Germain 1982
9. May invest in tangible personal property up to 10% of assets	Garn-St Germain 1982
10. May make educational loans up to 5% of assets	Garn-St Germain 1982
11. May make loans to Small Business Investment Corporations up to 1% of assets	Garn-St Germain 1982

It also should be noted that the 1982 act reflects what is undoubtedly Congress's fear that, if all restrictions and incentives were removed for S&Ls, they would diversify from being specialized housing lenders and would

become essentially indistinguishable from commercial banks. This fear is revealed in DIDMCA's provisions that (1) limit interstate branching activities by S&Ls that diversify to the point they no longer meet the IRS qualifying test and (2)

Table 2. Share of Commercial Loans at Maine Commercial Banks and Mutual Savings Banks

Year	MSB's		CB's	
	\$ (Millions)	Percent	\$ (Millions)	Percent
June 1975	3.7	.9	414.7	99.1
Dec. 1975	4.7	1.1	409.5	98.9
June 1976	5.1	1.2	421.5	98.8
Dec. 1976	5.6	1.3	440.3	98.7
June 1977	6.4	1.3	503.8	98.7
Dec. 1977	9.6	1.9	510.7	98.1

Source: McCall and Peterson (1980), Table 5

subject single S&L holding companies to the more stringent restrictions applicable to multi-S&L holding companies if their S&L subsidiaries fail to meet that test.

Despite the limitations contained in the 1980 and 1982 acts and Congress's failure to address needed tax-law modifications that would allow S&Ls to exploit fully the benefits of asset and liability diversification, the question remains: will S&Ls take advantage of their new powers and, if so, how fast?⁴ More important is the question of whether, if the tax obstacle and other disincentives to diversification were removed, S&Ls would be better off becoming full-service competitors to commercial banks or to remain specialized mortgage lenders. The next two sections will explore these issues.

Use of New Powers

One argument against granting S&Ls new powers is that their lack of expertise, especially in the commercial lending area, might lead to too rapid an expansion, over-extensions and unduly risky loans. Unanticipated increases in costs and potentially large losses would only exacerbate thrift earnings problem further. Four recent studies—by McCall and Peterson (1980), Dunham (1982), Baker (1982), and Crockett and King (1982)—all suggest these fears may be exaggerated. Left to their own devices, thrift managers do not seem to have this self-destruct tendency. Rather, they appear to have pursued a moderate approach in adjusting to newly authorized powers, especially on the asset side of the balance sheet.

⁴One of the difficulties is that the banking committees in Congress don't have the authority to initiate tax legislation. Thus, the Ways and Means Committee in the House, for example, would have to be educated to the need for this tax law change.

McCall and Peterson (1980) attempted to assess DIDMCA's likely impact on federally chartered thrifts by tracking the experience of state-chartered mutual savings banks (MSBs) and S&Ls in Maine that had been granted extended powers in 1975 when state banking statutes were revised significantly. State-chartered S&Ls and MSBs were granted a wide array of powers, including the authority to offer personal checking accounts, credit cards and consumer loans. In addition, Maine thrifts were authorized to make commercial loans up to 10 percent or more of assets if authorized by the state's superintendent of banking.⁵

It appears that Maine MSBs and S&Ls did not overreach themselves or expand too rapidly into areas where they lacked expertise. In particular, while they sought to take advantage of many of their new powers, most did not move into the credit card area nor did they offer overdraft lines of credit. On the liability side, while they moved quickly to offer NOW accounts, most were relatively cautious initially in offering either telephone transfer services or IRA accounts. This was also the case for MSBs making use of their commercial loan powers. MSBs made only \$3.7 million in commercial loans in 1975, less than .5 percent of all MSB loans (Table 2). MSBs accounted for less than 1 percent of the commercial loans made by MSBs and commercial banks combined. By year end 1977, MSBs had increased their commercial loans to \$9.6 million. But this still amounted to less than 2 percent of the commercial loans made by MSBs and commercial banks combined and less than 3/4 of 1 percent of all MSB loans. Undoubtedly, the inability to offer corporate checking accounts probably hindered Maine MSBs in making commercial loans. But the fact remains that the MSBs did not rush to offer below-market rates nor did they increase their portfolios via participation.

MSBs and S&Ls did move more aggressively than commercial banks in pricing and in advertising and other nonprice forms of competition for the new services that they offered. The exception was in the area of NOW accounts, where MSBs and commercial banks adopted similar pricing schedules but S&Ls were more aggressive in their pricing.

⁵These powers were broader than those given to S&Ls under the 1980 Act. In fact, the powers granted to federal MSBs by the 1980 act are more similar to those granted federal S&Ls under the 1982 act.

Table 3. Average Market Portfolio Composition for MSB's as of December 1980
% of Assets

STATE	Number of Markets	Demand Deposits	Time and Savings Deposits	NOW Accounts	Total Deposits	Residential Mortgages	Commercial Mortgages	Commercial Loans	Loans To Individuals	Total Loans
Massachusetts	13	.03	98.02	4.37	98.16	51.8	6.32	.15	4.5	64.6
Connecticut	6	1.11	96.40	.62	97.72	58.7	7.25	.63	5.7	74.0
Maine	8	.88	96.19	2.53	97.26	54.7	7.74	.44	7.1	70.9
New Hampshire	13	.13	96.87	4.64	97.11	55.6	8.69	.84	8.6	76.1
Vermont	9	1.41	92.98	.73	94.80	47.1	7.25	1.73	6.4	59.4
Rhode Island	2	.03	97.45	.35	97.75	57.8	7.40	1.50	4.9	73.6
Aggregate of all New England MSB's		.40	96.4	3.2	97.1	54.7	8.2	.6	5.5	70.8

Source: Dunham (1982) Table 2 Appendix

McCall and Peterson concluded that thrifts would respond to the 1980 legislation rapidly to take advantage of many newly authorized asset and liability powers, especially to provide services to consumers. If their evidence from Maine provides a useful guide, there is not likely to be a safety and soundness problem or radical shift in relative market shares of total deposits.

A more recent study of New England mutual savings banks by Dunham (1982) helps shed some light on how likely thrifts might be to exploit new powers. Dunham presents relative market shares and aggregate asset and liability compositions for MSBs in 51 New England metropolitan markets as of December 1980, several months after DIDMCA went into effect. Dunham's findings tended to reaffirm the general conclusions of McCall and Peterson. Mutual savings banks did take advantage of their new liability powers, but demand deposits and NOW accounts still accounted for only a small proportion of their liabilities (.4 percent and 3.2 percent, respectively as shown in Table 3). In only four of the 51 markets investigated did demand deposits account for more than 2 percent of MSB liabilities, and in only one market did NOW accounts exceed 7 percent.⁶ In fact, New England commercial banks on average had a higher proportion of NOW accounts (5.9 percent) than did MSBs (3.2 percent).

On the asset side, MSB commercial loans represented less than 1 percent of assets in 1980, and loans to individuals still accounted for

only 5.5 percent. In only four of the 51 markets did commercial loans exceed 2 percent of assets. There were, however, five markets in which loans to individuals exceeded 10 percent of assets.

The third and more relevant study of S&Ls' use of new powers is that of Baker (1982). Baker examines state-chartered S&Ls in Florida that have operated since July 1, 1980 under a liberalized statute permitting them many of the powers contained in the Garn-St. Germain Act. Most important are provisions enabling state-chartered S&Ls to offer transaction accounts to corporations (non-interest bearing NOW accounts), to make secured and unsecured loans for any purpose including commercial loans and to invest in obligations of state and local government provided at least 60 percent of assets (not including liquid assets) are invested in loans related to real estate. Again, the results suggest that S&Ls were cautious in taking advantage of their new powers. Baker indicates that the portfolio compositions of state and federal S&Ls differed only slightly. For example, as of June 1981, state S&Ls had 3.15 percent of their assets in non-liquid investments, compared with 1.33 percent for federal institutions. State S&Ls also had 2.53 percent of their assets in consumer loans, compared with 1.62 percent for federals. Lastly state S&Ls had only 0.7 percent of their assets in loans to businesses (as compared to 0.03 percent for federals). On the liability side, state S&Ls had only .1 percent of their deposits in non-interest bearing NOWs (NINOWs), presumably to corporations.

Clearly, high interest rates and poor earnings performance in 1980-81, restrictions (in certain

⁶This was in Massachusetts where MSBs have offered NOW accounts for several years. Interestingly, in none of the New Hampshire markets, where NOW accounts began in 1972, did they exceed 7 percent of MSB liabilities.

states) on making commercial loans and taking commercial deposits, and tax disincentives all impacted thrift institutions' ability to exploit new powers granted by various states. Newly chartered S&Ls, however, were not burdened by low-yielding mortgage portfolios. Hence, they were not as limited by earning difficulties in what they might do as were the more established firms.

Baker, in his Florida study, isolated S&Ls chartered since 1979 to examine whether they utilized their powers differently than established firms. The portfolio comparisons suggest that the key differences were in liquidity and in the proportion of assets held as loans. New S&Ls had only 44.97 percent of their assets in loans compared with 83.98 percent for more established state-chartered S&Ls. These newer S&Ls made a smaller proportion of consumer loans than did the older firms and held a slightly higher proportion of assets in non-liquid investments. They continued, however, to hold loan portfolios heavily concentrated in mortgages. Newer S&Ls held 95.6 percent of their loans in mortgages, compared with 96.2 percent for older S&Ls. The principal area of diversification was into liquid investments (obviously of shorter maturity than mortgages) rather than into other permissible types of loans or investments. Liquid assets at these new S&Ls were significantly higher at 37.3 percent of assets, compared with 6.5 percent for more mature S&Ls.

Most interesting is the earnings performance of these new Florida S&Ls. In 1981 they actually showed a positive net income as a percent of assets of .29 percent compared with only .02 percent for older state-chartered S&Ls and a net loss (.09 percent) for federal S&Ls in the state.

It is unlikely that this earnings performance of new S&Ls was due to lower cost of funds resulting from their new power to offer non-interest bearing deposit accounts; the proportions of deposits earning more than the passbook rate were fairly comparable for both new and established S&Ls. New S&Ls had 78.33 percent of their deposits earning more than the passbook rate, compared with 79.24 percent for federal S&Ls and 80.41 for older state-chartered S&Ls. It is more likely that the higher proportions of shorter

term, more liquid and interest-sensitive assets in the new S&Ls' portfolios contributed to their somewhat better earnings performance.

This inference is supported by fragmentary evidence on the performance of Massachusetts MSBs reported by Kopcke (1981). These institutions also held a lower proportion of mortgages as a proportion of assets (66 percent) and a higher proportion of securities and cash (26 percent) than S&Ls, and these MSBs reported a .17 percent return on assets in 1980 and .14 percent in the first half of 1981.⁷

Finally, Crockett and King studied the performance of state-chartered stock and mutual S&Ls in Texas that had been permitted broader asset powers. These powers exceed those given federal S&Ls in the Garn-St Germain Act and include (1) a wide range of consumer lending powers such as automobile loans and credit cards, (2) commercial lending and (3) real estate development.

Like thrift institutions studied elsewhere, these S&Ls have made very little use of their powers to date. Over 77 percent of the assets of state-chartered institutions (93 percent of loans) and over 80 percent of the assets for mutual S&Ls (92 percent of loans) remain in mortgages. Only about 3 percent of the state S&Ls' assets and 2.6 percent of mutuals' assets were in loans to consumers and an insignificant amount was in commercial loans (less than .25 percent).⁹ Unlike the new Florida S&Ls studied by Baker, the Texas S&Ls held only a small proportion of assets in liquid form; less than 10 percent of the assets of state S&Ls and 9 percent for mutuals were in cash and investment accounts.

Because Texas S&Ls have made little use of their broadened powers, Crockett and King (1982) conclude that these new assets have had little impact on profitability. Net income to assets was slightly higher for state institutions than for federals over the 1977-81 period examined, but all returns were usually within one basis point of each other. Moreover, losses were reported for all three categories of S&Ls in 1981, whereas Baker reported slight positive earnings for state-chartered Florida S&Ls.

⁷Kopcke (1981) Tables 1 and 3. Of course, this does not allow for the implied capital loss due to depreciation in the market value of mortgage portfolios.

⁸Kopcke (1981) compared the performance of Massachusetts MSBs with that of California S&Ls, which held 83 percent of their assets in mortgage loans and only 9 percent in securities and cash in 1980 and 81 percent and 8 percent during the first half of 1981, respectively. California S&Ls

returned .29 percent on assets in 1980 but lost .38 percent in the first half of 1981.

⁹Crockett and King (1982) do indicate (see their Table 7) that the large institutions tended to make greater use of expanded asset powers than smaller S&Ls. About 25 percent of most S&Ls smaller than \$50 million, for example, made business loans.

Unlike the other researchers, Crockett and King also attempted, using statistical cost regressions, to make inferences about the new assets' potential contribution to overall profitability. In general, they conclude that the new assets have net yields in excess of those on conventional mortgages. They estimate that these pretax net yields are close to those in mortgage-backed securities, ranging between 12 and 16 percent.

Voluntary Specialization

It is true that the analysis period of these studies was limited and that the S&Ls and mutuals examined did not, in some cases, have fully diversified powers. In Maine, for example, MSBs were able to make commercial loans but could not accept commercial demand deposits. Their inability to offer a package of deposit and loan services to business would significantly hamper the thrifts' competitiveness. Moreover, federal tax laws provided potential penalties for asset diversification below levels where they would meet IRS qualifying tests.¹⁰ Lastly, over the period studied, relatively high consumer loan and other interest rates and two recessions probably dampened demand for credit and thus limited diversification opportunities for thrifts in non-mortgage areas. All of these factors make it difficult to inferences from past thrift experience about the benefits of portfolio diversification.

A 1982 study by Eisenbeis and Kwast, however, may offer a clearer indication of the possible benefits to S&Ls of continuing to specialize in mortgage lending as opposed to diversifying into full-service competitors to commercial banks. They examined the performance of 254 commercial banks that voluntarily chose to specialize in mortgage and real estate lending over the 1970s. These firms held at least 65 percent of their loans in real estate loans for at least seven of the ten years between 1970 and 1979. These real estate banks (REBs) were very similar to the population of commercial banks at large with respect to size, geographical distribution, and urban-rural distribution. Fewer REBs were located in unit banking states and fewer were affiliated with bank holding companies than were other commercial banks. In general, however, except for their portfolios, these REBs did not appear to

Table 4. Profitability Comparisons (Average Percent per Year) All sample institutions

Year	(1) Return on Assets ¹			(2) Return on Equity ²		
	CB	REB	S&L	CB	REB	S&L
1971	.8	.9*	.6	10.0	10.2	9.8
1972	.8	.8*	.7	9.8	10.0	11.1
1973	.9+	1.0*	.7	10.9+	11.7*	12.4
1974	.9+	1.0*	.6	10.2+	11.0*	9.4
1975	.8	.8*	.5	9.1	9.5*	7.9
1976	.8+	.9*	.6	10.2+	11.3	11.2
1977	.9+	1.0*	.7	10.7+	11.9*	13.0
1978	.9+	1.0*	.7	11.1+	12.2*	13.4
1979	1.0	1.1*	.6	12.5	12.7	12.1

¹Net income defined as after taxes, securities gains and losses, operating expenses and extraordinary items.

²Equity defined as net worth.

REB is real estate specializing bank.

CB is sample of commercial banks.

+Significantly different from the REB mean at the 5 percent level.

*Significantly different from the S&L mean at the 5 percent level.

Source: Table 1A from Eisenbeis and Kwast (1982).

be atypical. The researchers felt that these banks' performance could serve as a reasonable proxy for how S&Ls with diversified powers might have performed over this same period; the authors also could compare the performance of these specialized real estate banks with that of regular commercial banks and with S&Ls as a whole. Thus, the comparisons permitted a more reliable test of the potential benefits of expanding thrift asset and liability powers.

That study's results are relevant to whether thrifts might be better off diversifying broadly or sticking to areas where they have developed special expertise. For example, as is shown in Table 4, in each of the 10 years Eisenbeis and Kwast studied, the REBs' net return on assets equaled or exceeded the control sample of commercial banks,¹¹ and REB returns exceeded that of S&Ls by 30 basis points (or by an average of 50 percent).¹² Thus, it appears that the REBs' decision to specialize in real estate lending over the period was both rational and profitable.

¹⁰The evidence does not suggest that either the tax laws or the percentage of asset restrictions were important constraints for most thrifts over the period.

¹¹REB net income to assets equaled that of the sample of commercial banks in 1975 and exceeded the ratio in the remaining nine years.

¹²Return on equity for the REBs exceeded that for the sample of commercial banks in all ten years.

Table 5. Asset Composition Comparisons: All Sample Institutions

Year	Liquid Assets			Other Assets			Total Loans			Consumer Loans		
	CB	REB	S&L	CB	REB	S&L	CB	REB	S&L	CB	REB	S&L
1971	50.4	50.2*	12.0	2.1+	1.6*	2.6	47.5	48.2*	85.7	13.8+	8.3*	0.3
1972	49.9	50.3*	10.7	2.1+	1.6*	2.4	48.0	48.1*	87.7	14.0+	8.2*	0.6
1973	48.4	47.9*	9.7	2.4+	1.7*	2.4	49.2	50.4*	88.7	14.5+	8.3*	0.7
1974	47.4	47.0*	9.8	2.8+	1.8*	2.5	49.8	51.2*	88.4	14.2+	8.0*	0.7
1975	47.5	47.4*	10.6	3.1+	1.9*	2.4	49.4	50.6*	87.5	14.4+	8.0*	0.6
1976	44.4	46.4*	10.4	3.0+	1.9*	2.3	52.6	51.6*	87.7	14.8+	8.2*	0.6
1977	42.9	44.4*	9.8	2.9+	2.0*	2.2	54.2	53.7*	88.7	15.6+	8.8*	0.6
1978	40.9	40.8*	9.6	3.1+	2.1	2.1	56.0	57.1*	88.8	16.4+	9.7*	0.5
1979	41.4	40.6*	9.8	3.2+	2.3	2.2	57.1	57.1*	88.6	15.6+	9.9*	0.5

+Significantly different from the REB mean at the 5 percent level.

*Significantly different from the S&L mean at the 5 percent level.

Source: Table 4A from Eisenbeis and Kwast (1982)

Interestingly, as Table 5 illustrates, this earnings performance was achieved with a portfolio balance of consumer loans, commercial loans and investments that lay within the limits permitted to federal S&Ls in 1982 under Garn-St Germain. For example, consumer loans of the REBs were less than 10 percent of assets, as were commercial and industrial loans, investments in state and local municipal securities and commercial real estate loans.

Freed from the tax penalty for diversifying out of mortgages and other qualifying assets, the real estate banks held a significantly smaller proportion of assets in loans than did S&Ls—but not a significantly different proportion in either loans or liquid assets than regular commercial banks. Real estate banks held an average of 4½ times the proportion of liquid assets as S&Ls over the study period and 60 percent of the loans. Interestingly, the REBs' asset portfolio composition differed little from portfolios of the new state-chartered Florida S&Ls studied by Baker (1982). The new S&Ls held about the same proportion of liquid assets and real estate loans as the REBs but a lower proportion of total loans to assets due to smaller relative holdings of consumer and "other" loans.

While differences in asset portfolio compositions probably help explain the REBs' earnings performance, S&L gross revenues as a percent of assets exceeded that of the REBs by an average of 11 percent and exceeded the sample of commercial banks by 7 percent. This suggests that expenses may be more important than revenues in explaining relative profitability.

Examining operating expenses and the components of expenses would provide some interesting and useful information to S&Ls if they are to take advantage of their new powers fully and to operate profitably as either specialized or diversified lenders. For example, S&L total operating expenses as a proportion of revenues averaged about 8.4 percent higher than the REBs even though S&L interest expenses to revenues exceeded the REBs by an average of 39 percent. S&Ls compensated for their higher interest expenses with lower "other operating expenses" relative to revenues—averaging about 55 percent below the REBs—and with substantially lower provisions for loan losses. The REBs' ratio of total operating expenses to revenues also averaged 4 percent lower than the commercial banks.¹³ Given the lower proportion of transactions balances, REB interest expense averaged about 20 percent higher than that of regular commercial banks. But this was more than offset by REBs' lower "other operating expenses," "other interest expense" and provisions for loan losses. Presumably the operating cost savings and lower loan loss provisions reflect one cost advantage of specialization.

Implications for S&L Diversification

These studies detailing how thrifts have used their new powers and the performance of diversified versus specialized lenders hold several important implications for policy and for S&L strategy.

¹³Total operating expenses as a percent of revenues for S&Ls also exceeded that of commercial banks by an average of 4.5 percent.

Table 5. Continued

Other Loans			Total Real Estate Loans			1-4 Family Real Estate Loans			Land Development Loans			Other Real Estate Loans		
CB	REB	S&L	CB	REB	S&L	CB	REB	S&L	CB	REB	S&L	CB	REB	S&L
19.9+	6.6*	0.8	13.7+	33.3*	84.2	7.9+	23.4*	71.8	NA	NA	0.2	5.8+	9.8*	12.2
19.3+	6.1*	0.8	14.7+	33.8*	85.6	8.4+	23.8*	71.0	NA	NA	0.2	6.2+	10.0*	14.4
19.6+	5.9*	0.8	15.1+	36.1*	86.4	8.5+	25.6*	71.2	NA	NA	0.3	6.6+	10.6*	15.0
20.0+	5.9*	0.9	15.6+	37.3*	86.1	9.0+	26.6*	70.6	NA	NA	0.3	6.6+	10.7*	15.2
19.6+	5.8*	0.9	15.3+	36.9*	85.4	8.9+	26.4*	69.0	NA	NA	0.3	6.4+	10.4*	16.1
20.8+	6.0*	0.9	17.0+	37.5*	85.7	9.4+	26.2*	69.2	1.0	1.0*	0.3	6.6+	10.2*	16.1
20.7+	6.0*	1.0	17.9+	38.8*	86.5	10.1+	27.5*	70.1	1.2	1.3*	0.3	6.5+	10.0*	16.1
20.1+	6.4*	1.0	19.5+	41.0*	86.8	11.2+	29.4*	70.8	1.5	1.5*	0.3	6.8+	10.1*	15.7
20.9+	6.6*	1.5	18.9+	40.6*	86.1	11.0+	29.6*	70.4	1.5	1.3*	0.3	6.5+	9.7*	15.3

Like most studies, some of their implications are comforting while others are cause for concern.

For example, fears that S&Ls will rush out and over-extend themselves in offering new services and in their pricing policies seem unfounded. In both New England and Florida, thrifts moved cautiously in offering new services, especially when diversifying outside their traditional areas of expertise or into market segments they had not traditionally served. Moreover, no evidence has been offered to date that too rapid or too aggressive expansion has played an important role in causing thrift failures or in creating problem institutions. In fact, one might even criticize the S&Ls for taking too little advantage of the opportunities available.

To be sure, this past experience may not be completely relevant since regulations constrained the thrifts from becoming full-service suppliers of services to commercial customers. In addition, thrifts were in better financial condition over the study period than they are presently. These cautions are counterbalanced by the many disincentives that continue to impede rapid use of new thrift powers. For example, the tax disincentives are still in place, and the expanded powers in the Garn-St Germain Act are available only to federally chartered thrifts.¹⁴ More than half of the nation's S&Ls and all but a dozen or so mutual savings banks are state chartered. Thus, thrifts must go through a conversion process or individual states will have to change their

statutes—both of which take time—before most thrifts can avail themselves of the new powers. (It should be noted, however, that many states already have laws granting state institutions powers parallel to those of federal institutions, and conversion is an inexpensive process.) Finally, the S&Ls' lack of expertise plus the costs of starting up new financial service activities should serve as short-run constraints to thrifts' rapid expansion.

Examining both the expense of the new S&Ls in Florida and the specialized real estate banks, it is hard to attribute their improved earnings performance to the ability to diversify into higher yielding assets. Instead the profit performance of the REBs appears to be associated with more favorable costs of funds. Unfortunately, diversification of S&L liabilities seems unlikely to generate the same benefits as has been the case for commercial banks and the REBs. Clearly, some of the apparent advantages enjoyed by REBs and banks over S&Ls in terms of costs of funds are offset by higher non-interest operating costs, some of which represent substitutes for explicit interest payments. The relaxation of deposit rate ceilings and increased competition for funds will tend to raise the cost of funds to banks and REBs and limit the earnings benefit S&Ls can achieve by offering transaction accounts to individuals and corporations.

In this respect, the recent studies only reinforce what many have contended all along. That is, while expansion of powers may be necessary to ensure the long-term viability of S&Ls, it probably does little to deal with short-run earning problems

¹⁴Mere conversion from S&L to savings bank status, moreover, would reduce the percentage of assets that must be held in qualifying form from 82 to 72 percent. Indeed many S&Ls are now beginning to explore the feasibility of such conversions. Baer (1983) also makes this point.

resulting from a large negative gap between their earnings on long-term assets and their costs of short-term funds. Surely, the drop in interest rates that began in the summer of 1982 occurred at a most opportune time and, if it persists, may provide S&Ls the flexibility to adapt to their expanded powers.

Short-Run Strategies

The results also suggest some short-run strategies for S&Ls to follow in order to make the best use of their diversified new powers. To achieve even the kind of diversification associated with the REBs, which are still specialized housing lenders, certain strategies are likely to be more effective than others.

For example, one common characteristic of the REBs, commercial banks and new Florida S&Ls is their substantial liquidity and low loan-to-asset ratios. With lower interest rates, the sale of assets and creation of mortgage-backed securities becomes more feasible than before (when large capital losses had to be realized) to reduce the dependency on mortgage loans. Channeling some of the proceeds into seasoned tax-free municipal securities with shorter maturities than the mortgages sold could help offset the tax disincentives to diversification and lower the effective maturity of S&L assets relative to liabilities. Baer (1983) explores in some detail the circumstances under which investments in tax-free instruments would facilitate further diversification as well. He concludes that the importance of the tax disincentives may have been somewhat overstated.

Similarly, rather than incurring the high start-up costs of creating a commercial financial service activity, an S&L could engage in commercial loan participations with commercial banks or other S&Ls.

Indeed, there is already evidence that major S&Ls are joining together in syndicates and are providing innovative kinds of financing to corporations.¹⁵ Savers Capital—a syndicate of several large S&Ls, for example, has begun to provide long term, secured, variable rate loans to major corporations. Not only do these loans provide financing on a participated basis, but also the lending agreements contain provisions which, under certain circumstances, may give the lenders equity interests in the form of stock warrants.¹⁶ Such joint venture activities serve to reduce pressure on non-interest operating costs while achieving the benefits of asset diversification. It may be cost-effective in the short-run to incur a large increase in operating costs in order to attract lower-cost corporate deposits if increases in operating costs are more than offset by the benefits of lower costs of funds.

Conclusions

This survey indicates that the passage of DIDMCA in 1980 and Garn-St Germain in 1982 did little to deal with S&Ls' short-run earnings problems. On the other hand, the study also suggests that if interest rates remain at lower levels, then these acts may go a long way to restoring full viability of thrifts. Most importantly, the results suggest that S&Ls may not have to become clones of commercial banks in order to operate successfully. In fact, they may even continue to exploit their existing expertise as specialized mortgage lenders with the expectation of being as profitable as more diversified lenders.

—Robert A. Eisenbeis

¹⁵Hill (1983) describes two such S&L syndicates.

¹⁶Slater (1983) indicates that Savers Capital has already made such a loan to Allegheny Beverage Corp.

*An earlier version of this paper was presented at the eighth annual conference of the Federal Home Loan Bank of San Francisco, December 9 and 10, 1982.

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Public Retirement Systems: Crucial to the Southeastern Economy?

Congress' approval of a \$165 billion Social Security rescue package this spring has heightened interest regarding the importance of retirement programs to people in the Southeast.

About 10 percent of the region's disposable personal income comes from public pension payments of various sorts. Older people (65 and over) now make up 12 percent of the region's population. Furthermore, both proportions have been growing rapidly in recent years. Census projects this trend to continue both because of the flow of new arrivals from other areas of the country and because of the aging local population. Given those trends, it is understandable that changes in retirement systems are of intense interest not only to older residents in the region but to large segments of the area's economy.

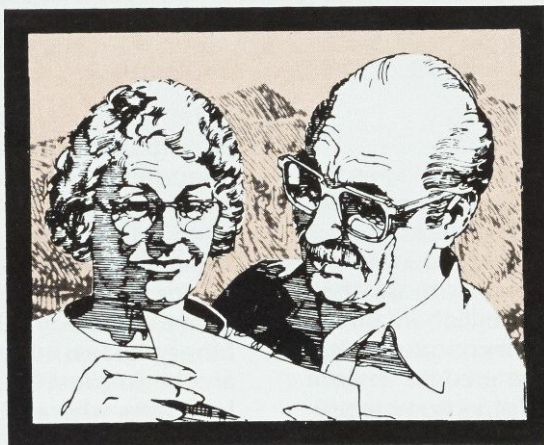
While the current and future costs of public retirement plans have attracted extensive research, little research has focused on the geographic distribution of public pensions. Yet it is widely recognized that some regions and states have a greater concentration of older Americans and therefore more reliance on public retirement

funds than others. So it would be logical to find that Florida's economy is more dependent on public retirement pensions than other states. Second, since workers in the Southeast states have incomes lower than the national average, the southeastern economy, in general, depends

more on the Social Security system than higher income regions do. Moreover, as Social Security payments replace a larger proportion of lower wage workers' pre-retirement income, retirement is encouraged more in lower wage regions like the Southeast.

In assessing the impact of such payments on the Southeast, we looked at unpublished Commerce Department data covering retirement benefits by regions under five

major systems: Old Age and Survivors Insurance (OASI) and Disability Insurance (DI), the largest programs under Social Security; Federal Railroad Retirement; Federal Civil Service; state and local government pensions, and military retirement pensions. The statistics we reviewed extend from 1959 through 1980, the latest year for which data were available.



A large and growing portion of the Southeast's disposable income comes from public pension payments. In particular, counties clustered around military bases and universities and in mountain areas depend substantially on the public pension system.

Table A. The Region's Residents Are Getting Older

	Population			Over 65 Population		
	1970	1980	Percent Change	1970	1980	Percent Change
Alabama	3,444,165	3,893,888	13.1	325,961	440,003	35.0
Florida	6,789,443	9,746,324	43.6	989,366	1,687,112	70.5
Georgia	4,589,575	5,463,105	19.0	367,458	518,164	41.0
Louisiana	3,641,306	4,205,900	15.5	306,707	403,187	31.5
Mississippi	2,216,912	2,520,638	13.7	222,320	288,742	29.9
Tennessee	3,923,687	4,591,120	17.0	383,925	517,572	34.8
District States	24,605,088	30,420,975	23.6	2,595,737	3,856,780	48.6
United States	203,211,926	226,545,805	11.5	20,065,502	25,542,863	27.3

Source: U. S. Department of Commerce, Bureau of the Census, **General Population Characteristic**, selected states, 1980.

Growth of Pension Plans

In 1959, public retirement plans dispensed \$13.8 billion to some 15 million beneficiaries nationwide. These payments accounted for 4.1 percent of the nation's disposable income. By 1980, these programs had grown more than tenfold. They distributed \$166 billion in annual pensions to some 45 million Americans, or 9.3 percent of national disposable income. Even if the federal government establishes no new programs to aid the elderly, the aging of our population and the programs already in place could exert further pressures on the Social Security Trust Fund after 2010.

In the eight-state Southeast region (the states of the Sixth Federal Reserve District plus North and South Carolina), the growth and relative importance of public pensions over the last two decades have proven even more dramatic than in the nation. In 1959, the five public pension systems dispensed \$1.6 billion in benefits or just under 4 percent of disposable personal income in the region. By 1980, these plans had expanded to \$28.4 billion, or approximately 10 percent of all disposable income in the eight-state Southeast. Thus, the relative importance of public pensions to the region has grown from about even with the national norm in 1959 to above the national average of 9.3 percent in 1980.

Although the rapid growth in funds disbursed through pensions is common in all eight southeastern states, the level and relative importance

differ markedly. Not surprisingly, Florida leads the region in both the magnitude and the relative importance of public pension income. For each \$1,000 of disposable income in the state in 1980, \$130 came from public pensions. That is 128.4 percent more than the \$57 per \$1,000 of disposable income in 1959, and 41.3 percent above the \$92 per \$1,000 nationally. Among other regional states, public retirement monies are the smallest fraction of disposable income in Louisiana, where \$81 per \$1,000 originates from this source. Due largely to the concentration of Alabama's economy in durable manufacturing, public retirement benefits, particularly Railroad Retirement, figure heavily in the "Heart of Dixie."

Yet the rate of increase in relative shares of spendable income made up of pension payments tells a different story. Although the rates of increase in relative importance of public pensions exceeded the nationwide rate of growth in all eight southeastern states, they grew most rapidly in Alabama. Between 1959 and 1980, public pensions as a share of disposable income tripled in Alabama while it doubled nationally. Strong economic growth in Florida contributed to a slower rate of increase in importance of public pensions, compared with other states with greater dependence on heavy manufacturing. Although the Sunshine State's dependency on public retirement monies rose over the period, the rate at which it increased was exceptionally slow in comparison to other states in the region and exceeded the nation by only a small margin.

Table B. A Substantial Amount of Public Pension Income Flows into the Southeast
(\$ Thousand) (As of 1980)

State/U. S.	OASI and DI	Railroad Retirement	Federal Civil Service	State and Local	Military Retirement	Total
Alabama	1,925,149	71,996	311,110	140,836	279,344	2,728,435
Florida	7,141,350	219,964	1,151,081	296,260	1,224,822	10,033,477
Georgia	2,334,054	100,618	371,415	225,268	424,503	3,455,858
Louisiana	1,747,426	64,070	158,259	292,349	197,301	2,459,405
Mississippi	1,166,250	43,561	133,371	87,609	147,758	1,578,549
North Carolina	2,746,916	67,786	118,000	108,184	191,432	3,232,318
South Carolina	1,359,065	36,992	191,394	118,938	306,167	2,012,556
Tennessee	2,240,406	96,513	211,010	200,412	233,904	2,982,245
Southeast	20,660,616	701,500	2,645,640	1,469,856	3,005,231	28,482,843
United States	118,654,000	4,801,000	15,504,000	14,880,000	12,428,000	166,267,000

Source: Unpublished data

Of the five public pension systems, OASI and DI are by far the largest. Of the \$28.4 billion dispensed to the eight-state region in 1980, almost three-quarters was Social Security. This amounted to 17.4 percent of the nationwide total compared with 15 percent of the over-65 population in these states. Next in importance was retirement pay to former military personnel. The \$3 billion issued in military retirement pay in 1980 represented 10.6 percent of the total public pension in the region but an astonishing 24 percent of national military retirement pay. Federal Civil Service pensions rank next in importance in the region with \$2.7 billion in benefits, or 9.3 percent of all pensions, followed by \$1.5 billion in pay to former state and local government workers and \$700 million in Railroad Retirement pensions.

Where are the Recipients Located?

We can begin to appreciate the importance of retirement income to the region, however, only by narrowing our focus. U.S.-to-region and state-to-state comparisons often mask important variations at the substate level. Since OASI and DI together account for the largest portion of retirement monies to the region, we focus exclusively on the distribution of Social Security at the

substate level. Georgia derived 5.3 percent of its personal income from Social Security payments in 1980. However, the proportions of county income made up of Social Security ranged from as low as 0.8 percent in Chattahoochee County to as high as 15.1 percent in Quitman. In Tennessee, Social Security accounts for 6.3 percent of statewide income but ranges from 3.9 percent in Williams County (Nashville) to as high as 12.2 percent in Lake County in the extreme northwestern corner of the state. See Table E for shares of county incomes comprised by Social Security payments for other states.

What similarities can we find in these counties that rely on Social Security for a high proportion of county income? To answer this question, we ranked each of the region's 533 counties according to their respective share of personal income comprised of Social Security payments. A color-coded map pinpoints common characteristics of counties where Social Security payments represent a high share of income.

Although the relationship is less than perfect, one factor many of these counties have in common is proximity to military facilities. In Georgia, Quitman and Twiggs counties provide excellent examples of the role of military facilities. Quitman County, south of Columbus, is a popular location for retired military personnel from Fort Benning

Table C. Social Security Payments are Critical to Fourteen Georgia Counties
(millions of dollars)

	Personal Income (\$)		OASDI (\$)		OASDI (%)	
Quitman	3.2	8.6	.314	1.315	9.8	15.1
Toombs	71.3	133.2	2.068	10.830	2.9	12.2
Twiggs	15.4	41.0	.620	2.693	4.0	12.0
Randolph	18.9	44.1	1.397	4.987	7.4	11.3
Chattooga	53.5	132.4	3.235	14.256	6.0	10.8
Taliaferro	5.2	13.1	.410	1.398	7.9	10.7
Fannin	29.1	83.5	1.946	8.800	6.7	10.5
Stewart	12.5	26.9	.773	2.838	6.2	10.4
Rabun	19.1	57.8	1.240	5.964	6.5	10.4
Webster	4.6	11.0	.204	0.908	4.4	10.4
Towns	8.8	29.4	.685	3.568	7.8	10.3
Union	12.8	40.1	.942	4.811	7.4	10.3
Whitfield	188.2	536.6	6.378	29.061	3.4	10.2
McIntosh	12.9	41.1	.893	4.216	6.9	10.2
14 Counties	455.5	1,098.8	21.105	95.645	4.6	8.7
State	15,303.0	44,043.7	532.692	2,334.054	3.4	5.3

Source: U. S. Department of Commerce Bureau of Economic Analysis, Regional Economic Information System and Federal Reserve Bank of Atlanta.

Army Base. Quitman's popularity is enhanced by the Walter F. George Reservoir along the western border of the county. Twiggs County, south of Macon in proximity to Warner Robins Air Force Base, has the third highest proportion of Social Security payments in the state. Residents in these two counties are more than twice as dependent on Social Security as the state as a whole.

A second interesting pattern is that many highly Social Security dependent counties are located in mountainous areas. The North Georgia counties of Chattooga, Fannin, Rabun, Towns, Union, Whitfield, and Gilmer depend on Social Security for a much higher proportion of county income than does Georgia as a whole. Similarly, five of Tennessee's ten counties most dependent on Social Security are located in the mountains. This feature, of course, is limited to only two of the states in the Sixth District.

The third factor responsible for high county concentrations of Social Security is proximity to large state universities. In three Alabama counties—Greene, Hale, and Perry—Social Security is twice as high as its proportion in the state as a whole. These counties are located southeast of Tuscaloosa, home of the University of Alabama, and

apparently are used as retirement communities for university faculty and staff. This above-normal share of county income in Social Security payments also characterizes Franklin County north of Athens, home of the University of Georgia.

Although the entire state of Florida has a higher concentration of Social Security payments than other states, some counties are more dependent than others. Three counties—Pasco, Hernando and Citrus—rely on Social Security payments for 16 percent or more of county-wide income. These counties are twice as dependent on Social Security as the state as a whole and as much as four times as dependent as the national norm. Furthermore, 24 more counties in Florida derive more than 10 percent of county income from Social Security, double the national share.

Louisiana and Mississippi are least dependent on Social Security payments. The most dependent county in Mississippi (Yalabusha, south of the University of Mississippi) derives about 12.3 percent of its income from Social Security. Sabine parish in Louisiana (neighboring Fort Polk Army Base) waits on the first of the month for about 12 percent of income.

The relative proportion of county income comprised of Social Security payments is not to be

Table D. Counties that Account for the Major Proportion of Social Security Payments (1980)
(Millions of Dollars)

Alabama	Florida	Georgia	Louisiana	Mississippi	Tennessee
Jefferson \$408.5	Broward \$970.6	Fulton \$284.4	Orleans \$299.8	Hinds \$113.2	Shelby \$342.7
Mobile 170.6	Dade 933.8	Dekalb 182.0	Jefferson 165.8	Harrison 65.8	Davidson 233.6
Montgomery 86.8	Pinellas 847.4	Chatham 102.3	E. Baton Rouge 126.2	Jackson 40.3	Knox 163.5
Madison 65.0	Palm Beach 563.9	Cobb 93.5	Caddo 122.6	Lauderdale 39.6	Hamilton 158.7
Etowah 64.0	Hillsborough 339.4	Bibb 77.5	Culcasicu 72.8	Jones 37.5	Sullivan 78.1
Tuscaloosa 60.5	Sarasota 275.6	Muscogee 76.5	Ouachita 58.7	Forrest 35.9	Washington 46.5
Calhoun 58.0	Duval 256.8	Richmond 72.5	Rapides 59.7	Washington 33.3	Blount 45.7
Walker 93.8	Orange 252.3	Floyd 46.0	Lafayette 40.5	Lee 29.5	Madison 37.2
Baldwin 42.9	Volusia 247.7	Clayton 40.8	Tammany 40.2	Lowndes 22.9	Anderson 35.9
Morgan 41.6	Pasco 230.7	Gwinett 38.5	Landry 37.2	Warren 21.3	Gibson 32.3
10 Counties 1,041.8	4,918.2	1,014.3	1,018.5	439.3	1,174.2
Percent of State 54.1%	68.9%	43.5%	58.3%	37.8%	52.1%

confused with the dollar amounts of such payments. In Georgia, although the highest concentration of Social Security payments in county income is in Quitman County, it is far from being the state's largest Social Security county. Fulton County (Atlanta) receives by far the largest dollar amount of Social Security payments—\$284.7 million in 1980. Dekalb County was next largest but a distant second to Fulton with \$182 million in 1980. Chatham County (Savannah), received \$102.3 million followed by Cobb (Atlanta), Bibb (Macon) and Muscogee (Columbus), respectively.

As Table D shows, counties where the largest dollar amounts of Social Security money flow are generally the more populous. Jefferson County (Birmingham) received \$408.5 million in 1980 compared to 170.6 million in Mobile County. Three Florida counties—Broward, Dade, and Pinellas—received \$2.8 billion in Social Security payments in 1980.

Why Worry Over Changes in the System?

Social welfare spending grew from \$14 billion, or 5.3 percent of gross national product, in 1950 to \$317 billion, or 13.9 percent of GNP in 1979. Thus, over a span of only three decades, the relative size of government social welfare expenditures increased over 160 percent. However, the growth of expenditures for OASI and DI over this period was even greater. In 1950, only

\$800 million, or 0.3 percent, of our national income went to these two major Social Security programs. By 1980, they had grown to \$166 billion, or 5.9 percent, of GNP. Today Social Security comprises 26.7 percent of federal government outlays, making it the largest single item in the federal budget.

The Social Security system's rapid expansion triggered a crisis that forced congressional action early in 1983. Every minute, the system was paying out \$17,000 more in benefits than it collected in taxes. At that rate, the trust fund on which nearly 32 million pension checks are drawn monthly would soon have been empty. Congress undoubtedly would have come under tremendous pressure to keep the elderly from falling behind in paying rent, food, and fuel bills.

The Social Security rescue plan signed by President Reagan will raise the retirement age to 67 in the next century, increase payroll taxes in 1984 and 1988-1989, freeze benefits for six months, subject some retirees' benefits to income tax for the first time, and require all federal employees hired after next January to join the system.

Perhaps the most important impact of the new bill on the program's 36 million beneficiaries—retirees, disabled workers, and their kin—will be the six-month delay in their annual cost-of-living adjustment from July to next January. Since the CPI rose by roughly 3 percent between 1982-11

Table E. Relative Concentration of Social Security Income in Southeastern States and Counties/Parishes (1980)
(U. S. = 5.2)

State Rank	Alabama (6.6)	Florida (8.1)	Georgia (5.3)	Louisiana (4.9)	Mississippi (7.0)	Tennessee (6.3)
1	Crenshaw (9.3)	Citrus (19.0)	Quitman (15.1)	Sabine (10.9)	Yalobusha (12.3)	Lake (12.2)
2	Randolph (9.2)	Pasco (18.6)	Toombs (12.2)	West Carroll (10.7)	Lawrence (12.4)	Fentress (11.7)
3	Covington (8.8)	Hernando (16.9)	Twiggs (12.0)	Madison (10.1)	Attala (12.0)	Pickett (11.2)
4	Hale (8.5)	Charlotte (14.6)	Randolph (11.3)	La Salle (9.6)	Montgomery (11.8)	Polk (11.1)
5	Perry (8.0)	Franklin (14.1)	Chattooga (10.8)	Bienville (9.2)	Holmes (11.3)	Campbell (11.0)
6	Franklin (8.0)	Highlands (13.9)	Taliaferro (10.7)	Allen (9.2)	Quitman (11.3)	Perry (10.7)
7	Butler (8.0)	Lake (12.3)	Fannin (10.5)	Jackson (9.1)	Newton (10.9)	Gibson (10.4)
8	Coneuh (7.8)	Manatee (12.1)	Stewart (10.4)	Washington (8.9)	Franklin (10.7)	White (10.3)
9	Wilcox (7.7)	Pinellas (12.0)	Rabun (10.4)	Caldwell (8.8)	Carroll (10.6)	Lauderdale (10.1)
10	Tallahassee (7.7)	Sarasota (12.0)	Webster (10.4)	Grant (8.8)	Calhoun (10.7)	Overton (9.6)
11	Union (7.7)	Marion (12.0)	Towns (10.3)	Winn (8.6)	Tallahatchee (10.0)	Carroll (9.9)
12	Greene (7.7)	Volusia (12.0)	Union (10.3)	Claiborne (8.5)	Noxubee (10.1)	Grundy (9.9)
13	Bibb (7.6)	Washington (11.2)	Whitfield (10.2)	Franklin (8.4)	Kemper (10.1)	Cumberland (9.9)
14	Coosa (7.5)	Putnam (11.2)	McIntosh (10.2)	Webster (8.3)	Leake (10.0)	Crockett (9.8)
15	Talladega (7.3)	Oceola (11.1)	Clay (10.2)	Union (8.3)	Marion (9.8)	Weakley (9.8)
16	Marion (7.3)	Calhoun (11.0)	Calhoun (10.0)	Desoto (8.2)	George (9.8)	Bledsoe (9.7)
17	Henry (7.3)	Liberty (11.0)	Pierce (9.8)	Tensas (8.2)	Walthall (9.8)	Stewart (9.7)
18	Dekalb (7.3)	Sumter (10.9)	Franklin (9.7)	Avoyelles (8.0)	Sharkey (9.7)	Henry (9.7)
19	Clay (7.3)	Okeechobee (10.9)	Worth (9.7)	Catahoula (8.0)	Pike (9.7)	Houston (9.6)
20	Choctaw (7.3)	Lee (10.9)	Greene (9.4)	Evangeline (7.8)	Copiah (8.4)	Hardeman (9.4)

and 1983-II, the delay will cost the typical retiree, who gets \$408 a month, roughly \$13 a month or about \$80 over the next six months. The most radical change, however, is the taxing of benefits. Starting next year, retirees will pay income tax on half of their Social Security benefits if their adjusted gross income, including Social Security, exceeds \$25,000 for an individual and \$32,000 for a couple.

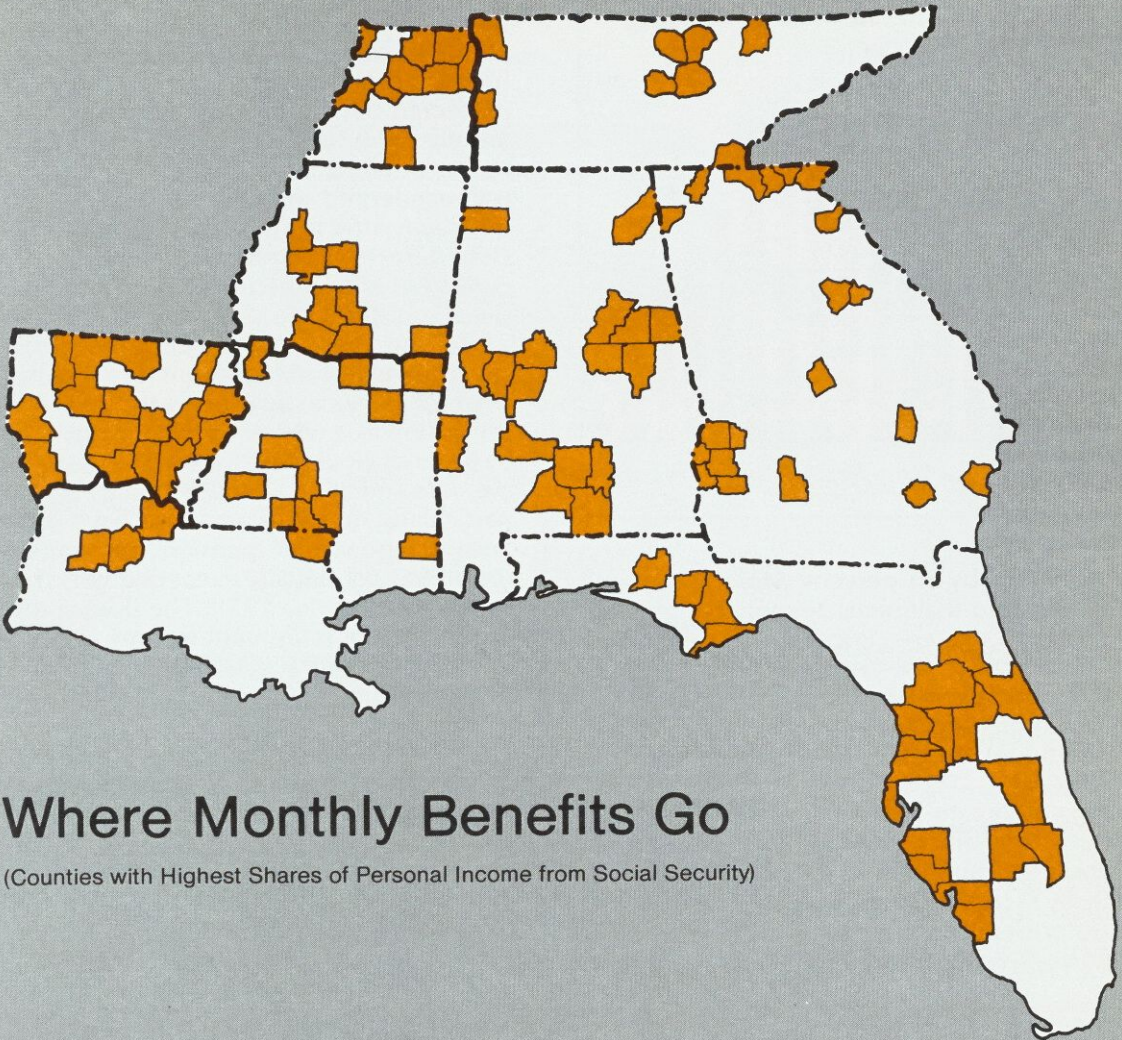
The bill also boosts the tax rate paid by employers and the self-employed. In the past, employee and employers paid an equal share of the tax. Beginning next January, both worker and employer will pay 7 percent of the applicant wage base in taxes—up from 6.7 percent this year. But three-tenths of one percent of the employee's share will be returned in the form of an income tax credit. The self-employed—a growing segment of the work force—will pay 11.3 percent in 1984 instead of the current 9.35 percent and 13.02 percent by 1988.

The legal retirement age also will increase. Currently at 65, the retirement age for which a worker is entitled to the full benefits will increase in two phases. Starting in the year 2003 the retirement age will increase by two months per

year until it reaches 66 in 2009. Between 2021 and 2027, the legal retirement age will increase to 67. This does not mean that people will not be able to retire at age 62. Instead, the percent of full benefits that those retiring at age 62 are eligible for will be only 70 percent instead of the current 80 percent.

The final important provision relates to coverage of the Social Security system. Beginning next year, members of Congress, congressional employees, federal judges, and other high level federal executives will be compelled to join the Social Security system. Moreover, all federal workers hired after 1983 will be required to join the system as will all employees of not-for-profit hospitals, colleges and other non-profit organizations.

The financial squeeze on the Social Security Trust Fund that dictated congressional action is portrayed vividly in the chart on page 70. The fund produced annual surpluses from 1967 to 1975. Over that period the balance doubled from \$19.9 billion in 1966 to \$39.9 billion in fiscal 1975. After 1975, benefit payments began to exceed taxes. The balance in the trust fund shrank from \$39.9 billion in 1975 to only \$12.6



Where Monthly Benefits Go

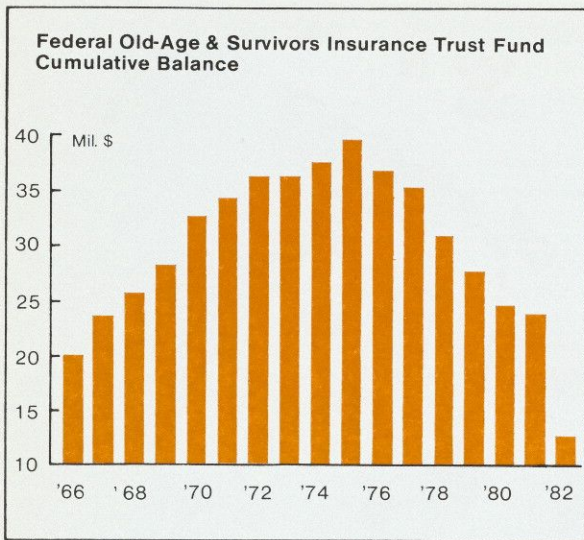
(Counties with Highest Shares of Personal Income from Social Security)

billion in 1982. Congress had addressed the problem previously by raising both the tax rate and the wage base. In 1966, the Social Security tax rate was only 4.2 percent of the first \$6,600 in wage income. By 1983, the rate had increased to 6.7 percent on the first \$35,700 in annual wages. Thus, payroll taxes for a worker and employer with earnings at or above the maximum wage base rose from \$554.40 in 1966 to \$4,783.80 in 1983.

Causes of the system's persistent financial problems are deeply rooted. First and perhaps of foremost importance is an unfavorable demographic mix. The aging population has changed the pattern between people benefiting from the

program compared to the number of workers paying into it. The ratio of workers paying into the system to people drawing benefits has fallen from 16.5 to 1 in 1950 to 3.2 to 1 today. Starting in the year 2010, an unprecedented number of Americans will begin to retire. Meanwhile, the working population will have been reduced by the low birth rates during the last 20 years. It is conceivable that the worker-beneficiary ratio could fall even further by the year 2030. If this occurs payroll taxes could eventually rise to 25 percent of wage and salary disbursements.

The second factor affecting the financial soundness of the Social Security system is political. In 1972, Congress passed a bill raising Social Se-



curity benefits by 20 percent. More important, the bill decreed that Social Security benefits be keyed to the Consumer Price Index beginning in 1975. If the CPI in the first quarter of any given year averaged more than 3 percent higher than it was 12 months earlier, benefits would be raised by an amount equal to the full increase the following July.

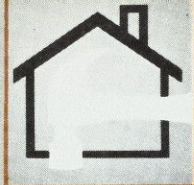
As a measure to protect the elderly against inflation, the bill contained serious imperfections. For example, the CPI was influenced heavily by increases in housing prices and mortgage interest rates, but relatively few elderly people buy houses. Many have already provided

for housing prior to retirement, as is indicated by the popularity of living areas in the vicinity of places of former employment such as military bases and universities. Thus the measure over-protected the elderly from housing inflation. In any case, the resulting benefit increases proved to be poorly timed as the CPI rose at rates unprecedented in U.S. history in the year immediately after the cost-of-living adjustment became effective. The maximum yearly Social Security benefit leaped 200 percent during the decade of the 1970s.

We can draw two conclusions. First, these public pension funds account for a slightly higher share of personal income in the region than in the nation as a whole. Therefore, any change in those funds would have a somewhat disproportionate consequence on the region in general and particularly on those areas we have discussed. Second, growth of pension payments in the region has continually exceeded growth of personal income since 1959. The disproportionate importance of retirement income is due largely to the region's attractiveness to retirees as well as to the method by which monthly benefits are determined.

As the national population continues to age, counties near the north Georgia mountains, military bases and state universities in the Southeast are likely to grow faster than other counties. Health care services can be expected to expand in these areas to accommodate a growing elderly population.

—Charlie Carter



CONSTRUCTION

	APR 1983	MAR 1983	APR 1982	ANN % CHG		APR 1983	MAR 1983	APR 1982	ANN % CHG
12-month Cumulative Rate									
UNITED STATES									
Nonresidential Building Permits - \$ Mil.					Residential Building Permits				
Total Nonresidential	44,768	44,533	51,168	- 13	Value - \$ Mil.	47,933	45,373	36,074	+33
Industrial Bldgs.	4,669	4,783	6,842	- 32	Residential Permits - Thous.				
Offices	11,130	11,255	15,028	- 26	Single-family units	655.6	620.5	488.6	+34
Stores	5,391	5,186	5,918	- 9	Multi-family units	520.8	500.2	385.5	+35
Hospitals	1,832	1,778	1,594	+ 15	Total Building Permits				
Schools	875	812	793	+ 10	Value - \$ Mil.	92,702	89,907	87,242	+ 6
SOUTHEAST									
Nonresidential Building Permits - \$ Mil.					Residential Building Permits				
Total Nonresidential	6,815	6,582	6,627	+ 3	Value - \$ Mil.	8,516	8,056	7,049	+21
Industrial Bldgs.	618	634	810	- 24	Residential Permits - Thous.				
Offices	1,558	1,443	1,351	+ 15	Single-family units	135.9	128.7	100.0	+36
Stores	963	962	1,107	- 13	Multi-family units	102.3	96.1	88.2	+16
Hospitals	398	377	286	+ 39	Total Building Permits				
Schools	165	136	89	+ 85	Value - \$ Mil.	15,331	14,638	13,677	+12
ALABAMA									
Nonresidential Building Permits - \$ Mil.					Residential Building Permits				
Total Nonresidential	348	377	422	- 18	Value - \$ Mil.	295	274	250	+18
Industrial Bldgs.	34	40	80	- 58	Residential Permits - Thous.				
Offices	72	73	36	+100	Single-family units	6.3	5.9	4.2	+50
Stores	46	67	68	- 32	Multi-family units	4.6	4.3	4.9	- 6
Hospitals	29	30	32	- 9	Total Building Permits				
Schools	5	5	6	- 17	Value - \$ Mil.	643	651	672	- 4
FLORIDA									
Nonresidential Building Permits - \$ Mil.					Residential Building Permits				
Total Nonresidential	3,543	3,398	3,355	+ 6	Value - \$ Mil.	4,891	4,678	4,715	+ 4
Industrial Bldgs.	331	354	391	- 15	Residential Permits - Thous.				
Offices	812	718	588	+ 38	Single-family units	70.3	66.6	57.6	+22
Stores	566	549	591	- 4	Multi-family units	59.4	57.0	58.9	+ 1
Hospitals	229	210	160	+ 43	Total Building Permits				
Schools	54	53	23	+135	Value - \$ Mil.	8,433	8,076	8,070	+ 4
GEORGIA									
Nonresidential Building Permits - \$ Mil.					Residential Building Permits				
Total Nonresidential	1,043	983	1,046	- 0	Value - \$ Mil.	1,719	1,586	1,011	+70
Industrial Bldgs.	135	127	178	- 24	Residential Permits - Thous.				
Offices	248	229	255	- 3	Single-family units	31.7	30.0	19.7	+61
Stores	88	84	119	- 26	Multi-family units	17.5	15.0	9.9	+77
Hospitals	25	26	30	- 17	Total Building Permits				
Schools	25	10	33	- 24	Value - \$ Mil.	2,762	2,568	2,057	+34
LOUISIANA									
Nonresidential Building Permits - \$ Mil.					Residential Building Permits				
Total Nonresidential	1,103	1,064	910	+ 21	Value - \$ Mil.	797	758	557	+43
Industrial Bldgs.	59	61	90	- 34	Residential Permits - Thous.				
Offices	320	316	294	+ 9	Single-family units	13.7	12.9	9.0	+52
Stores	113	122	175	- 35	Multi-family units	10.6	10.1	7.6	+39
Hospitals	61	60	27	+126	Total Building Permits				
Schools	68	53	19	+258	Value - \$ Mil.	1,901	1,822	1,468	+29
MISSISSIPPI									
Nonresidential Building Permits - \$ Mil.					Residential Building Permits				
Total Nonresidential	163	169	178	- 8	Value - \$ Mil.	218	208	137	+59
Industrial Bldgs.	8	11	22	- 64	Residential Permits - Thous.				
Offices	16	16	44	- 64	Single-family units	4.0	3.9	2.9	+38
Stores	33	40	37	- 11	Multi-family units	2.7	2.5	1.7	+59
Hospitals	12	10	6	+100	Total Building Permits				
Schools	5	5	1	+400	Value - \$ Mil.	381	377	315	+21
TENNESSEE									
Nonresidential Building Permits - \$ Mil.					Residential Building Permits				
Total Nonresidential	615	591	716	- 14	Value - \$ Mil.	597	552	379	+58
Industrial Bldgs.	49	40	49	0	Residential Permits - Thous.				
Offices	89	92	134	- 34	Single-family units	9.9	9.4	6.6	+50
Stores	116	100	116	0	Multi-family units	7.5	7.2	5.2	+44
Hospitals	41	42	22	+ 86	Total Building Permits				
Schools	7	9	7	0	Value - \$ Mil.	1,211	1,143	1,095	+11

NOTES:

Data supplied by the U. S. Bureau of the Census, Housing Units Authorized By Building Permits and Public Contracts, C-40. Nonresidential data excludes the cost of construction for publicly owned buildings. The southeast data represent the total of the six states. The annual percent change calculation is based on the most recent month over prior year. Publication of F. W. Dodge construction contracts has been discontinued.



EMPLOYMENT

	APR 1983	MAR 1983	APR 1982	ANN. % CHG.		APR 1983	MAR 1983	APR 1982	ANN. % CHG.
UNITED STATES									
Civilian Labor Force - thous.	109,875	109,873	108,814	+ 1	Nonfarm Employment- thous.	89,117	88,341	89,984	- 1
Total Employed - thous.	98,840	97,994	98,858	- 0	Manufacturing	18,287	18,161	19,073	- 4
Total Unemployed - thous.	11,035	11,879	9,957	+11	Construction	3,671	3,486	3,796	- 3
Unemployment Rate - % SA	10.2	10.3	9.3		Trade	20,374	20,173	20,446	- 0
Insured Unemployment - thous.	N.A.	N.A.	N.A.		Government	16,019	16,044	16,154	- 1
Insured Unempl. Rate - %	N.A.	N.A.	N.A.		Services	19,457	19,237	18,967	+ 3
Mfg. Avg. Wkly. Hours	39.7	39.6	38.7	+ 3	Fin., Ins., & Real Est.	5,408	5,374	5,319	+ 2
Mfg. Avg. Wkly. Earn. - \$	349	347	326	+ 7	Trans. Com. & Pub. Util.	4,920	4,885	5,058	- 3
SOUTHEAST									
Civilian Labor Force - thous.	14,168	14,040	13,911	+ 2	Nonfarm Employment- thous.	11,433	11,388	11,460	- 0
Total Employed - thous.	12,757	12,537	12,630	+ 1	Manufacturing	2,134	2,129	2,200	- 3
Total Unemployed - thous.	1,412	1,503	1,281	+10	Construction	609	603	660	- 8
Unemployment Rate - % SA	10.3	10.6	9.9		Trade	2,709	2,697	2,685	+ 1
Insured Unemployment - thous.	N.A.	N.A.	N.A.		Government	2,179	2,173	2,172	+ 0
Insured Unempl. Rate - %	N.A.	N.A.	N.A.		Services	2,302	2,293	2,235	+ 3
Mfg. Avg. Wkly. Hours	40.0	39.9	39.1	+ 2	Fin., Ins., & Real Est.	662	657	648	+ 2
Mfg. Avg. Wkly. Earn. - \$	304	302	286	+ 6	Trans. Com. & Pub. Util.	693	691	702	- 1
ALABAMA									
Civilian Labor Force - thous.	1,730	1,740	1,699	+ 2	Nonfarm Employment- thous.	1,309	1,304	1,327	- 1
Total Employed - thous.	1,496	1,478	1,476	+ 1	Manufacturing	329	327	345	- 5
Total Unemployed - thous.	234	262	223	+ 5	Construction	59	58	56	+ 5
Unemployment Rate - % SA	14.4	14.7	14.0		Trade	266	264	268	- 1
Insured Unemployment - thous.	N.A.	N.A.	N.A.		Government	292	292	293	- 0
Insured Unempl. Rate - %	N.A.	N.A.	N.A.		Services	220	219	217	+ 1
Mfg. Avg. Wkly. Hours	40.2	39.8	39.1	+ 3	Fin., Ins., & Real Est.	59	60	59	0
Mfg. Avg. Wkly. Earn. - \$	304	301	288	+ 6	Trans. Com. & Pub. Util.	70	70	72	- 3
FLORIDA									
Civilian Labor Force - thous.	4,727	4,610	4,607	+ 3	Nonfarm Employment- thous.	3,857	3,855	3,796	+ 2
Total Employed - thous.	4,332	4,202	4,244	+ 2	Manufacturing	461	463	465	- 1
Total Unemployed - thous.	395	408	363	+ 9	Construction	236	236	258	- 9
Unemployment Rate - % SA	8.6	8.9	8.7		Trade	1,027	1,028	1,003	+ 2
Insured Unemployment - thous.	N.A.	N.A.	N.A.		Government	650	645	644	+ 1
Insured Unempl. Rate - %	N.A.	N.A.	N.A.		Services	944	950	906	+ 4
Mfg. Avg. Wkly. Hours	40.2	40.3	39.0	+ 3	Fin., Ins., & Real Est.	291	288	281	+ 4
Mfg. Avg. Wkly. Earn. - \$	293	294	269	+ 9	Trans. Com. & Pub. Util.	235	235	229	+ 3
GEORGIA									
Civilian Labor Force - thous.	2,689	2,677	2,641	+ 2	Nonfarm Employment- thous.	2,227	2,209	2,205	+ 1
Total Employed - thous.	2,495	2,460	2,447	+ 2	Manufacturing	497	495	505	- 2
Total Unemployed - thous.	194	217	194	0	Construction	98	95	104	- 6
Unemployment Rate - % SA	7.6	8.3	7.7		Trade	528	521	517	+ 2
Insured Unemployment - thous.	N.A.	N.A.	N.A.		Government	445	445	438	+ 2
Insured Unempl. Rate - %	N.A.	N.A.	N.A.		Services	388	384	370	+ 5
Mfg. Avg. Wkly. Hours	40.5	40.3	38.6	+ 5	Fin., Ins., & Real Est.	119	118	116	+ 3
Mfg. Avg. Wkly. Earn. - \$	283	285	258	+10	Trans. Com. & Pub. Util.	145	145	147	- 1
LOUISIANA									
Civilian Labor Force - thous.	1,843	1,844	1,836	+ 0	Nonfarm Employment- thous.	1,590	1,588	1,624	- 2
Total Employed - thous.	1,624	1,616	1,669	- 3	Manufacturing	192	192	208	- 8
Total Unemployed - thous.	219	228	167	+31	Construction	116	115	124	- 6
Unemployment Rate - % SA	11.9	12.3	10.4		Trade	364	364	368	- 1
Insured Unemployment - thous.	N.A.	N.A.	N.A.		Government	313	313	309	+ 1
Insured Unempl. Rate - %	N.A.	N.A.	N.A.		Services	308	307	305	+ 1
Mfg. Avg. Wkly. Hours	39.8	39.9	40.9	- 3	Fin., Ins., & Real Est.	80	80	79	+ 1
Mfg. Avg. Wkly. Earn. - \$	387	382	384	+ 1	Trans. Com. & Pub. Util.	125	124	130	- 4
MISSISSIPPI									
Civilian Labor Force - thous.	1,053	1,052	1,057	- 0	Nonfarm Employment- thous.	787	783	800	- 2
Total Employed - thous.	933	930	945	- 1	Manufacturing	197	196	205	- 4
Total Unemployed - thous.	120	122	112	+ 7	Construction	40	39	42	- 5
Unemployment Rate - % SA	12.3	11.4	10.4		Trade	161	159	161	0
Insured Unemployment - thous.	N.A.	N.A.	N.A.		Government	182	182	184	- 1
Insured Unempl. Rate - %	N.A.	N.A.	N.A.		Services	124	124	123	+ 1
Mfg. Avg. Wkly. Hours	39.5	39.2	38.6	+ 2	Fin., Ins., & Real Est.	33	33	33	0
Mfg. Avg. Wkly. Earn. - \$	262	258	246	+ 7	Trans. Com. & Pub. Util.	39	38	40	- 3
TENNESSEE									
Civilian Labor Force - thous.	2,126	2,117	2,071	+ 3	Nonfarm Employment- thous.	1,663	1,649	1,708	- 3
Total Employed - thous.	1,877	1,851	1,849	+ 2	Manufacturing	458	456	472	- 3
Total Unemployed - thous.	250	266	222	+13	Construction	60	60	76	-21
Unemployment Rate - % SA	11.9	12.0	11.1		Trade	363	361	368	- 1
Insured Unemployment - thous.	N.A.	N.A.	N.A.		Government	297	296	304	- 2
Insured Unempl. Rate - %	N.A.	N.A.	N.A.		Services	318	309	314	+ 1
Mfg. Avg. Wkly. Hours	39.9	39.7	38.1	+ 5	Fin., Ins., & Real Est.	80	80	80	0
Mfg. Avg. Wkly. Earn. - \$	296	294	271	+ 9	Trans. Com. & Pub. Util.	79	79	84	- 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.

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Special Issue: Displacing the Chair

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