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The Ledger

Economic Education Newsletter

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Economic Highlights of 1993

There was no shortage of economic news in 1993. Trade barriers toppled in North America and around the globe. Citizens of the former Soviet Union and former defense workers in the United States continued to grapple with post-Cold War realities. Some Americans lost everything to surging floodwaters, and the federal government tried to deal with a flood of budgetary red ink. Sears closed the book on its catalog sales unit after 97 years, but QVC Network and Home Shopping Network announced a planned merger that was sure to pique the interest of stay-at-home shoppers. Japan's economy went into a skid, and Detroit turned a corner in its drive to make a comeback against foreign auto makers.

What follows is a recap of last year's economic highlights. As always, the standard caveat applies: We make no claim that ours is the definitive list, nor do we pretend to offer an in-depth analysis of each event. We leave that task in your capable hands.

High Drama, Lower Tariffs

The debate over the North American Free Trade Agreement (NAFTA) was like the Superbowl — only more suspenseful. The outcome was always in doubt, and everyone seemed to have a "rooting interest."

Erstwhile third-party presidential candidate Ross Perot predicted that ratification of the agreement would be followed by the "giant sucking sound" of U.S. jobs flowing to Mexico. NAFTA backers claimed that failure to ratify the pact would jeopardize relations with Mexico (the third biggest market for U.S. exports) and undercut the president's effectiveness in upcoming trade talks with Asian and European leaders.

The issue pitted traditional political allies against one another and forced habitual foes to set aside past differences. Organized labor, which had backed Bill Clinton's run for the White House, lobbied vigorously to block the agreement, and a number of key Democrats declined to support it. Much of the responsibility for shepherding NAFTA through Congress fell to House Republicans.

At the outset, chances for ratification appeared slim. Proponents gained momentum as the debate progressed, but even the treaty's most enthusiastic supporters were circumspect in their predictions.

The outcome of the final vote took nearly everyone by surprise. On November 17, the U.S. House of Representatives approved the North American Free Trade Agreement by a comfortable margin: 234-200. As a result, tariffs on 99 percent of the goods traded between the United States and Mexico will be completely phased out over the next 15 years, and goods and services will move freely across what is already one of the world's least fortified borders. (Canada and the United States had concluded their own free trade agreement in 1989. NAFTA added Mexico.)

A month later, in December, most free trade proponents breathed a sigh of relief when a flurry of last-minute compromises in Geneva, Switzerland brought GATT negotiations to a successful conclusion. The so-called Uruguay Round of the General Agreement on Tariffs and Trade (GATT) had begun seven years earlier, and a hemisphere away, in Punta del Este, Uruguay.

The GATT talks were scheduled to end in mid-December, and there was to be no extension of the deadline. Failure to reach an agreement might well have resulted in retaliatory trade practices and higher tariffs.

With only days remaining, negotiators had yet to resolve a number of the most intractable issues. The French fought hard (and successfully) to retain quotas on the number of American movies and TV shows permitted to run on European television, but they also reluctantly agreed to slash subsidies to French farmers. The Americans sought (unsuccessfully) to limit government subsidies to European aircraft manufacturers, but managed to win agreement on a broad range of tariff reductions.

In the end, more than 100 nations agreed to a global trade pact that reduced industrial tariffs by an average of one-third and addressed such politically sensitive issues as agricultural subsidies and patent protection. The final result, although less than perfect, was certainly preferable to the disruption in trade that might have occurred in its absence.

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Natural Disasters: Mississippi River Floods/ California Wildfires Blaze

Technological progress sometimes lull humans into believing they have mastered the forces of nature. But then nature asserts itself and snaps everyone back to reality.

Residents of the American Midwest spent much of last summer trying to cope with unrelenting downpours, rising floodwaters, and mud. The rains began in April and refused to let up for the next three months. Day after day, storm clouds doused the region with incredible amounts of water, and when the flow of water outstripped the rivers' capacity to channel it away, the water gushed into farmers' fields or swamped riverfront cities and towns.

By the end of July, floodwaters had covered more than 13 million acres and caused an estimated $10 billion worth of damage. Stretches of the Mississippi River were closed to barge traffic for nearly two months. Des Moines, Iowa was without running water for 12 days after the Raccoon River overflowed its banks and flooded the city's water treatment plant.

Communities protected by existing levees and floodwalls managed to escape the worst damage. And residents of unprotected communities were often able to save themselves by joining together and scrambling to build temporary levees. But there were times when even the best efforts of good people could not stem the flow of rising water. (Ironically, the permanent flood control measures that saved some communities may have doomed others. Some observers contend that levees and floodwalls forced raging rivers into narrower channels, and the resulting bottleneck either forced water back upstream or sent it flowing higher and faster downstream.)

When the rains finally stopped and the floodwaters began to subside, people all along the upper Mississippi and the lower Missouri began to salvage what remained of their possessions. The thick, gumbo-like mud that covered floors, walls, and everything else made the task all the more disheartening.

All too often, flood victims suffered total financial loss. According to some estimates, as many as 80 percent of the people in the Midwest's designated flood-hazard zones had opted not to purchase coverage offered by the National Flood Insurance Program. Although the program endeavors to make such coverage affordable, many would-be purchasers were nevertheless deterred by the cost. Others simply had gambled and lost.

The cost and magnitude of the clean-up prompted many to question whether or not disaster-prone areas should be rebuilt. It's a question that arose again in October when more than a dozen wildfires scorched the hills and canyons surrounding Los Angeles. Windswept flames reduced million-dollar houses to ashes in a matter of minutes. Total damage estimates exceeded $500 million.

A number of the blazes may have been set deliberately; one was sparked accidentally by the campfire of a homeless man trying to keep warm. But in many respects, the California conflagration was a natural disaster

Much of the countryside has been described as a "natural tinderbox." The least little spark can ignite the chaparral, sage scrub, and other underbrush that is so prevalent in the region. And when hot, dry Santa Ana winds blow in off the Mojave Desert, they act as a natural bellows and fan the flames.

For as long as anyone can remember, seasonal wildfires have burned off the old undergrowth to make way for the new. It's the natural scheme of things. The problem is that houses now dot the fire zone — big, expensive houses. And when the fires sweep through, as they always have, a lot of high-priced real estate goes up in smoke.

Although California's wildfire victims and the victims of other natural disasters are almost always eager to pick up the pieces and get back to the way things were, insurers and government officials are beginning to question the wisdom of rebuilding in locations that are so prone to natural calamity. Last April, in what may be the start of a trend, Allstate Insurance announced plans to let policies lapse for 300,000 of its Florida customers. Allstate's announcement came less than a year after Hurricane Andrew had leveled parts of southern Florida.

Reversal of Fortune: Japanese Economy Sputters

During the 1980s, the Japanese could do no wrong. The world rushed to buy Japanese products, which had earned a well-deserved reputation for quality and value, and Japan made the transition from economic powerhouse to economic superpower.

Japan's most spectacular run of prosperity occurred between 1986 and 1990. The Japanese stock market skyrocketed, and the Japanese real estate market boomed. The run-up in share prices was especially noteworthy because Japanese investors had long been wary of investing in stocks, preferring instead to keep their money in the bank. Flush with new wealth, Japanese consumers went on a spending spree. Car sales in Japan jumped from just over 3 million in 1987 to just under 5 million in 1990.

Economic success also translated into a renewed sense of self-confidence and national pride. The Japanese began to talk more openly of asserting greater influence in world affairs.

Then, in 1990, Japan began to experience a full-blown economic downturn. The Japanese stock market's Nikkei average (a rough equivalent of the Dow Jones average) plummeted from a peak of 38,915 in 1989 to a low of 14,309 in August 1992. Real estate values tumbled as well, and banks struggled to cope with the resulting increase in bad debt. At the same time, many Japanese industries faced stiff competition from Pacific Rim countries with lower labor costs. In the face of all these new difficulties, Japanese consumers turned conservative, and companies looked for ways to cut jobs — a drastic step in a country where people expect to stay with the same employer for life.

Japan's economic woes also prompted talk of a comeback for Detroit's "Big Three" —General Motors, Ford, and Chrysler. Since the 1970s, Japanese auto manufacturers had consistently topped Detroit in price, reliability, and styling. American nameplates rarely appeared in the top ten of anyone's customer satisfaction survey. A growing number of U.S. car buyers refused

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for only 14 percent of the South African population, whites own 90 percent of the land and nearly 90 percent of the established businesses. They have enjoyed one of the world's highest standards of living, while the black majority has endured grinding poverty and political repression.

The international community expressed its opposition to apartheid through economic and cultural sanctions. More than 200 U.S. companies left South Africa between 1985 and 1990; some because they disapproved of apartheid, and others because they feared for the future or because they experienced political and economic pressure at home.

South Africa's whites responded to the sanctions by turning inward and settling into a siege mentality. Despite their growing isolation, they showed little inclination to relinquish power or privilege to the country's black majority. A violent showdown between the two groups seemed inevitable.

Then, in 1990, the situation began to change more rapidly than anyone could have predicted. Nelson Mandela, leader of the African National Congress (ANC), was released from prison after being held since the early 1960s for advocating armed resistance to apartheid. And by the end of 1991, leaders of the country's diverse political factions had entered into discussions over the transition to a multiracial society. A key factor in bringing them together was their shared concern over South Africa's deteriorating economy.

Last year's developments in South Africa were no less than stunning. In June, black and white politicians announced an agreement to hold the country's first all-inclusive, multiracial elections on April 24, 1994. In September, the South African Parliament ratified a power-sharing agreement with the ANC, and Nelson Mandela called for an end to economic sanctions against his country. And in November, President Clinton lifted all remaining U.S. sanctions.

Of course, there are still many difficulties ahead. South Africa's economy is in the grip of a severe recession. Nearly half of its black population is unemployed. The political rift between Nelson Mandela's ANC and Zulu Chief Mangosuthu Buthelezi's Inkatha Freedom Party appears to be deepening. And diehard South African whites are demanding a separate state.

But for all that, there are still signs of hope. Nelson Mandela continues to display political courage and a remarkable capacity to eschew bitterness. South African President F.W. De Klerk continues to display an equally remarkable capacity to break free of the belief system that kept apartheid in place for more than 40 years. And both leaders seem to realize that a peaceful transition from apartheid to full democracy depends largely on their willingness to implement viable economic policies and attract foreign investment.

Deficit Reduction: Parting the Sea of Red

When Ronald Reagan took office in 1981, the national debt was just under $1 trillion. By the time Bill Clinton moved into the White House twelve years later, the debt had mushroomed to $4.4 trillion.

Throughout the 1980s, federal budget deficits routinely topped $200 billion. Politicians, economists, financial analysts, central bankers, and average citizens all predicted dire consequences if the trend were to continue.

But budget deficits and the federal debt are issues that are easier to address in the abstract than in actuality. Reducing spending and raising taxes are two things that most politicians would prefer to sidestep, and with good reason. Talk of meaningful spending cuts must eventually get around to entitlements — social security, Medicare, the home mortgage interest deduction — and each of these has a powerful constituency. Any politician who votes to raise taxes is giving his or her opponent a powerful weapon to use in the next election.

Last year's Congressional debates over deficit reduction illustrated the complexity of the problem. Both the House and the Senate narrowly approved deficit reduction packages, but the two were decidedly different. The House version, which passed in May by a vote of 219-213, included a broad-based tax on energy consumption. A month later, the Senate version rejected the energy tax in favor of a much narrower tax on gasoline and diesel. Again, the vote was close, 50-49, with Vice President Gore casting the tie-breaking vote. Still in doubt, however, was the question of whether or not the House and Senate could reconcile their bills.

The President and his staff lobbied hard for passage of a compromise bill. In their view, the future of the Clinton presidency was at stake. Defeat of the deficit reduction measure would likely hinder the Administration's effectiveness in upcoming battles over NAFTA, health care, and other key issues.

The deciding vote came in August, and Vice President Gore was again called upon to break a tie (50-50) in the Senate. The compromise deficit reduction package contained the following key provisions:

- The tax rate for individuals earning over $115,000 went from 31 percent to 36 percent ($140,000 for couples). Those earning more than $250,000 also faced a 10 percent surcharge.

- The federal tax on gasoline and diesel fuel jumped by 4.3 cents per gallon, raising the total to 18.4 cents per gallon on gasoline and 24.4 cents per gallon on diesel.

- Approximately 5.5 million retirees saw taxes increase on their Social Security benefits.

In addition, defense spending was cut further, and the rate of increase in the Medicare budget was slowed, which means that Medicare spending will probably grow by $272 billion instead of $328 billion over the next five years. And in spite of all that, most Washington observers believe last year's deficit reduction package was only the beginning of what promises to be a long and difficult process.

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traffic-control talents of one of America's most technically sophisticated telephone companies.

The possibilities inherent in such a partnership range from the mundane — ordering up your favorite old television program at 2:00 a.m. from a video library — to the exotic. Imagine being able to book seats for a performance at an unfamiliar theater without having to deal with a surly ticket agent. Theoretically, an interactive video system would not only enable the customer to order tickets but also to check out the sightlines of the available seats by using virtual reality technology.

Of course, it remains to be seen whether or not a merger between two very different communications giants is economically viable. But one thing already seems certain: The technological potential will be limited only by the human imagination and customer demand.

Note: The Bell Atlantic/TCI merger collapsed in February 1994. Both companies blamed the deal's failure on the Federal Communication Commission's decision to back a 7 percent reduction in cable TV subscriber rates, which the companies feared would make the union economically unfeasible. But "cold feet" and concern over the fit between two very different corporate cultures might also have been factors. In any case, the collapse of the Bell Atlantic/TCI merger could well be one of 1994's economic highlights.

Adjusting to the End of the Cold War

Communism collapsed, the Cold War ended, and nearly everyone looked ahead to a brighter, more prosperous future. Sounds like a happy ending to a story that lasted more than 40 years.

But some stories never seem to end. The difficult process of adjusting to post-Cold War realities continued to make headlines in 1993.

Tensions rose to a new level in Russia, where President Boris Yeltsin dissolved Parliament in September and called for new elections. Yeltsin blamed Parliament for blocking economic reforms. Parliamentary deputies responded by elevating Yeltsin's vocal opponent, Vice President Alexander Rutskoi, to the presidency after voting to strip Yeltsin of power. The recalcitrant deputies then barricaded themselves inside Parliament, and a two-week standoff ensued. The standoff ended when Russian paratroopers, backed by T-72 tanks, blew out all 500 of the parliament building's windows, setting it ablaze and forcing its occupants to surrender.

Those who opposed Yeltsin did so for a variety of reasons. Some were nationalists dismayed by the Soviet Union's sudden disintegration and its loss of superpower status. But many others were "voting their pocketbooks" when they defied Yeltsin's order to dissolve parliament. Some were old-line communists seeking to retain their influence and personal privilege; others believed Yeltsin's economic reforms were progressing too rapidly and causing undue hardship.

The transition to a market economy had begun during the late-1980s and had been arduous. Last January prices rose by 28 percent a month, which translates into an annual rate of more than 1,800 percent. By December, the rate of increase had moderated to 12 percent a month, but in order to win that improvement the government had sharply curtailed industrial subsidies and other programs intended to soften the impact of economic change.

The political cost of pursuing such a course became apparent when Russian voters went to the polls in December 1993. They narrowly approved a new constitution that greatly expanded Yeltsin's powers, but they also voted in large numbers for communist and ultranationalist candidates for parliament. The Liberal Democratic party headed by ultranationalist Vladimir Zhirinovsky fared surprisingly well, in large part because of voter dissatisfaction with reformist economic policies and Russia's diminished status as a world power.

Reportedly, Zhirinovsky had once said he would erect giant fans on Russia's border with Lithuania in order to blow toxic gases toward the Baltic state. Needless to say, his strong showing in the elections raised concerns in Europe, the United States, and the former Soviet republics.

The end of the Cold War also had a significant, if less dramatic, effect on the U.S. economy in 1993. With the collapse of the Soviet Union and Eastern Bloc communism, Congress and the president were free to look for ways to trim U.S. defense expenditures.

In the abstract, most Americans seemed to agree that the defense budget could be cut without endangering national security. But specific cuts were another matter altogether, because defense cuts ultimately meant job losses and economic dislocation.

Sections of the country such as California and New England, which had prospered during the defense build-up of the 1980s, were hit first and hit hardest by the defense cuts of the 1990s. But last year the pain spread when the Pentagon announced that 31 major military bases would close and 134 others would face cutbacks. The base closings could eventually save the taxpayers more than $3 billion a year, but thousands of defense workers will lose their jobs and civilian businesses in the affected communities will face a bleak future.

There is some hope of converting defense plants and military bases to other uses, but beating swords into ploughshares is no easy task. Defense contractors are involved in a highly specialized business. Producing military hardware to Pentagon specifications is a far cry from selling consumer goods in a highly competitive market. And even the most creative approaches to recycling old military facilities probably won't help the 58-year old who's spent the past 35 years welding nuclear submarines.

The United States Ends Economic Sanctions Against South Africa

For more than 40 years, South Africa's white minority has controlled that country's government and economy through a cruel system of racial separation known as apartheid. Although they account

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to even consider buying American, and by 1990 Japanese car companies had captured nearly 25 percent of the U.S. auto market.

But in 1993, after years of trying to catch up, an entry from the "Big Three" once again became the top-selling car in the United States when Ford Taurus nosed out Honda Accord. And for the first time in years, the Japanese share of the U.S. market had begun to slip.

Detroit's renewed focus on value and quality was winning back American customers — with a little help from the foreign exchange markets. During the mid-1980s, the exchange rate was approximately 240 yen to the dollar, but by 1993 it had fallen to 110. In simple terms, a pricetag of 3 million yen translates into $12,500 when the exchange rate is 240, but when it drops to 110 yen per dollar, 3 million yen equals $27,000. At that rate, manufacturers must reduce profit margins and develop innovative strategies in order to maintain market share — which the Japanese have done to a remarkable extent. One response has been to build many more cars in the United States: Toyota Camrys are built in Kentucky, Honda Accords are assembled in Ohio, and Nissan Altimas are put together in Tennessee. Nevertheless, a typical mid-priced Japanese car still costs more and is often less well-equipped than its American competition.

In short, the outlook for American auto companies is brighter than it has been in years. But in view of the resilience, the ingenuity, and the commitment to quality that the Japanese have demonstrated, Detroit ought not to spend much time celebrating its comeback.

Changing the Way America Shops: Demise of the Sears Catalog/ Birth of the Information Highway

At the height of the Cold War, *New York Times* columnist Harrison Salisbury offered a tongue-in-cheek alternative to massive defense spending: Send U.S. planes to drop millions of Sears catalogs on the Soviet Union. The eye-popping array of readily available consumer goods would convert the Soviets from communism to capitalism in no time.

Today, the Soviet Union and the Sears catalog are both gone. Soviet communism collapsed during the late-1980s, and the Sears catalog met its demise last year. Of the two, Sears' "big book" lasted longer and is more fondly remembered. (The catalog, which made its debut in 1896, predated the Bolshevik revolution by more than 20 years.) At one time, only the Bible graced the bookshelves of more American homes.

The Sears catalog brought the outside world to isolated farms and out-of-the-way small towns that the railroads and the main highways had bypassed. It offered shoppers whatever they needed or wanted — everything from water pumps to ready-made curtains.

The "big book" was an American institution, but like many institutions it was slow to recognize that times change. During the 1980s, when smaller catalog companies were targeting specialty markets and making catalog shopping as easy as possible for busy consumers, Sears continued to publish its 1,500-page catch-all edition and dragged its feet on adopting a 24-hour toll free number for telephone sales. By 1992, Sears' catalog division was $175 million in the red (even though sales for the year topped $3 billion).

To make matters worse, Sears, which had long been America's largest retailer, had fallen to number three, behind Wal-Mart and K-Mart. Faced with the need for drastic action, Sears' new chairman began 1993 by doing away with the catalog unit — a move that would close 113 stores and eliminate 50,000 jobs.

But new ways of marketing and delivering goods, services, and information continued to evolve last year. In July, America's two largest video retailers, QVC and Home Shopping Network, announced plans for a $1.2 billion merger which could boost the prospects of an industry that has yet to realize its full potential.

Gross sales for all video retailers topped $2 billion in 1993. That's not bad for an industry that didn't even exist 15 years ago, but the figure could be much higher. Part of the problem is that home shopping channels don't attract as many viewers as they could, nor do they attract the most affluent.

Since its debut in the early 1980s, video retailing has grappled with the age-old shopkeeper's challenge of "getting customers into the store." Only a relatively small percentage of all TV viewers watch home shopping channels, in part because TV shopping still suffers from an image problem; call it the "cubic zirconia syndrome." Shoppers searching for value and quality are likely to look elsewhere, put off by the combination of middling merchandise and bare bones production techniques that owe more to community access television than to MTV.

The QVC-HSN merger could change all that by giving the new company sufficient financial resources to establish an interactive video equivalent to a super Sears catalog. Instead of placing a telephone order for whatever the home shopping channels choose to showcase, viewers could electronically browse the wares of any outlet or vendor that signs on with QVC-HSN and then place an on-line, on-screen order.

Even bigger changes appeared to be on the way last October when Bell Atlantic Corporation and Tele-Communications Inc. (TCI) announced plans for a $33 billion dollar blockbuster merger. Bell Atlantic is one of the so-called "Baby Bell" regional phone companies created by the AT&T break-up, and TCI is the nation's largest cable TV operator.

The union of a major telephone company and a cable TV giant could revolutionize the way Americans live, work, play, and shop. In an article for the October 14, 1993 edition of the *New York Times*, reporter John Markoff explains why:

Currently, cable networks have the capacity to carry hundreds of channels of television programs or other information, but most cable systems are not very good at letting consumers send information back over the network, whether to order a movie or play video games with other cable customers.

Telephone "channels," by contrast, can handle only limited amounts of information, but they have an almost magical ability through switching systems to let anyone on the network communicate with anyone else.

Therein lies the promise of this mega-merger, which will blend the information cargo-carrying capacity of the nation's largest cable company and the

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Multi-Media

The Basics of Foreign Trade and Exchange, booklet, published by the Federal Reserve Bank of New York, 48 pages.

The mere mention of the words "foreign trade" or "foreign exchange" is enough to induce flu-like symptoms in most Americans; perhaps because the topic seems arcane and intimidating. But a new publication from the Federal Reserve Bank of New York offers a remedy.

The Basics of Foreign Trade and Exchange is intended to introduce high school and junior college students to key concepts and fundamental issues related to trade, comparative advantage, competitiveness, exchange rates and currency trading, and the free trade vs. protectionism debate. And it does so in a way that makes the material interesting and accessible.

Basics is available free of charge to educators and students. For nonclassroom use, the first copy is free, additional copies cost $1 each. To request copies, contact:

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Making Sense of Savings, brochure, published by the Board of Governors of the Federal Reserve System.

The Federal Reserve Board has prepared a new brochure to help consumers understand their options and make better decisions about how and where to save their money. The brochure, entitled *Making Sense of Savings*, describes the various savings instruments that are available and explains their features — including fees and interest rates. It also covers the major features of the Truth in Savings Act.

For a free copy of *Savings Makes Sense*, write to:

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Multiple copies for classroom use are also available free of charge.

What Your Credit Report Says About You, brochure, published by the Federal Reserve Bank of Philadelphia.

Most buyers finance their houses with mortgages and pay for their cars with loans. College students often borrow to pay their tuition bills. And lots of people use credit cards to make purchases.

Of course banks and other lenders never know for sure if they will be repaid, but they can narrow the odds by looking at whether or not a potential borrower has repaid past debts. To obtain this information, lenders rely heavily on credit bureaus and credit reports.

What Your Credit Report Says About You, a new publication from the Federal Reserve Bank of Philadelphia, takes the mystery out of credit reports and credit bureaus by explaining what they are and describing the information contained in a credit report. It also explains how to obtain a copy of your credit report and what to do if it contains an error.

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EDITOR
ROBERT JABAILY

GRAPHIC DESIGNER
KRISTEN TAYLOR YARRANTON

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