Voice

of the Federal Reserve Bank of Dallas

El Paso · Houston · San Antonio

July 1979

Since You Asked

A fringe benefit of working at a Federal Reserve Bank is the frequent invitation to speak before various groups. And speeches inevitably generate questions. This is a brief response to the question asked most frequently following speeches during the past month.

"Seriously, do you really think we can reduce regulation and make the economy more competitive, more flexible?"

Yes, we have to!

Answering the question thus, I am reminded of the parent who, in telling his child a story about a rabbit, got the rabbit into a fix from which the only escape was by climbing a tree. So, the rabbit climbed a tree. To the child's protest that rabbits can't climb trees, the parent replied, "But he had to!"

We have to find ways to make our economy more competitive, more flexible, in order to achieve and maintain an efficient economy that provides full employment without inflation. We must reduce or eliminate anticompetitive laws and regulations and reorient those retained so as to make them procompetitive if we are to whip inflation, maintain full employment, and adapt successfully to the ongoing flow of economic, political, and technological events, domestic and foreign. The alternative is even more comprehensive Government control and direction of the economy and of individuals' private lives as the struggle to rationalize full employment and price stability continues.

It will not be easy to make the economy more flexible, and probably it will not be done quickly, although it should be. If accomplished at all, it probably will be done item by item, step by step. The comprehensive panoply of anticompetitive laws and regulations has been put in place item by item, step by step, through many years, usually to provide special benefits or protections to identifiable groups or interests. While in some instances the benefits have eroded through time and the interest groups have lost identity, most laws and regulations that restrict competition and rheumatize the economy have active supporters and a more or less plausible rationale.

If nearly all prices and wage rates were promptly responsive to changes in supplies or demands, there would be no need for widespread or extended periods of idleness of either labor or industrial or agricultural capacity. As unemployed resources began to increase, wages and prices would sag, and employment and production could be maintained. We need not face periodically, as we presently do, the prospect of both substantial

unused resources—called a recession—and raging inflation. With wage and price flexibility, monetary and fiscal policy could achieve and maintain what now seems only a distant vision, stable prices and full employment *at the same time.*

Competition and price and wage flexibility, of course, are popular only as abstract concepts. That's why yeoman efforts have been made by so many to circumscribe them and, once they are circumscribed, to resist any moves to reinvigorate them. The list of examples is long—agriculture, finance, labor, oil, and trucking, just to mention some obvious ones. And dire consequences are widely predicted of any proposals to deregulate them. However, evidence to date indicates both the airlines and airline passengers are benefiting handsomely from the increased competition and greater flexibility now flowing from the deregulation in that industry, as are the airplane manufacturers and their employees.

So, like the rabbit, we must do that which we're told can't be done. But we have scaled unscalable heights before. We should be able to do it again.

—Ernest T. Baughman
President, Federal Reserve Bank of Dallas

Carter Proposes Legislation to Help Small Savers

President Carter has recommended that Congress pass legislation phasing out interest rate ceilings currently in place under Federal Reserve Regulation Q on all consumer deposits. The President asked for legislation that would permit an orderly transition period, allowing rates to rise to market levels, but he did not specify a timetable. The primary reason for proposing the elimination of the Regulation Q ceilings was to enable small savers to receive the same rate of return on their deposits that is available to the large investors.

The President also called for legislation that would—

- Allow all federally chartered savings institutions to offer variable-rate mortgages.
- Allow all federally chartered savings institutions to invest up to 10 percent of their assets in consumer loans.
- Permit nationwide interest-bearing checking accounts.

The White House proposals came out of a two-year task force study under the chairmanship of the Treasury Department. Other task force members included representatives from the Department of Housing and Urban Development, the President's Council of Economic Advisers, the Office of Management and Budget, the White House Domestic Policy Staff, and the President's adviser on consumer affairs. The Federal financial institution regulators also worked closely with the task force.

U.S.-Mexico Border Industry Back on Fast-Growth Track

By Edward L. McClelland

Mexico's border industrialization program is expanding rapidly again after several years of decline and uneven recovery. The border industrialization program is known variously as in-bond plants, twin plants, border assembly plants, the border industry, or *maquiladoras*.[1] It allows U.S. manufacturers to establish assembly plants south of the border and to pay tariff only on the value added by the processing in Mexico. The major benefit to U.S. firms is lower labor costs; for Mexico, it is jobs. For Mexico's fast-growing labor force, the program will provide an estimated 110,000 to 115,000 manufacturing jobs this year—up nearly 20 percent from last year.

Continued growth of border industries is a major economic goal of the Mexican government. At the beginning of his adminstration in December 1976, President Jose Lopez Portillo set several goals for the *maquiladora* industry during his six-year term. They were to create 175,000 new jobs, increase the value of the program's exports by more than $1 billion, increase the proportion of Mexican materials used by border plants to 3 billion pesos for 1982, promote the manufacture in Mexico of products currently imported by twin plants, and promote increased national and foreign investment in border industries.

It is estimated that for every manufacturing job created at in-bond plants in Mexico, two new employees are required at U.S. plants. Moreover, for every dollar of income earned by twin-plant workers along the border, as much as 30 cents is spent in U.S. border cities; by that estimate the amount totaled about $75 million last year.

Mexico's success in achieving its objectives will have a direct impact on the U.S. economy, particularly in the Southwest. For example, it is estimated that for every manufacturing job created at in-bond plants in Mexico, two new employees are required at U.S. plants. Moreover, for every dollar of income earned by twin-plant workers along the border, as much as 30 cents is spent in U.S. border cities; by that estimate the amount totaled about $75 million last year.

1. For prior reports on the U.S.- Mexican border industrial program, see Lacy H. Hunt, II, "Industrial Development on the Mexican Border," *Business Review*, Federal Reserve Bank of Dallas, February 1970, and Myron T. Butler, "Border Industries—Inflation in Mexico and Recession in U.S. Threaten Maquiladora Accomplishments," *Business Review*, Federal Reserve Bank of Dallas, July 1975.

The border industrialization program . . .
Labor-intensive industries in the United States were forced to diversify overseas in the late fifties and early sixties because their survival was threatened by rising domestic labor costs and low-priced imports from Japan and Western Europe. The result was an exodus of assembly operations to low-wage areas in the Far East and Caribbean basin. In the view of U.S. labor leaders, the moves were prime examples of exporting domestic jobs. But firms squeezed by foreign competition had little choice—they had to reduce production costs or close down or cut costs by moving.

While inexpensive labor was, and still is, the primary motive for expanding overseas, other considerations play important roles in site selection. The distance to foreign plants from the United States adds to total costs of production because maintaining a long "pipeline" of materials, components, and semifinished goods to and from overseas locations can more than offset any savings gained in utilizing foreign labor. The quality and productivity of the local labor force and political stability of the host government are also important factors in selecting sites for foreign operations. And after 20 years of industrial development, the supply of suitable labor is nearly exhausted in some countries, and wage rates have risen to uncompetitive levels. Moreover, space is often not available or is very expensive in heavily populated areas.

Although Mexico is close by and has productive workers and a stable government, legal barriers impeded the establishment of assembly plants south of the border during the early stages of the foreign migration. Those obstacles were removed by the Mexican government after the termination of the *bracero* program in 1964. The *bracero* program had been established in 1951 to enable Mexican workers to be employed in seasonal agricultural jobs in the United States. After its termination, 185,000 jobless farm laborers returned home to Mexico.

The Mexican government initiated the border industrialization program to employ the growing number of idled workers and improve economic conditions along the northern border. The basis of the twin-plant program with the United States is the Tariff Classification Act of 1962; Section 806.30 applies to metal processing, and Section 807.00 applies to assembly of general components. The act allows U.S. manufacturers to export materials and components to foreign countries for processing or assembly and import the semifinished goods duty free except for the value added by processing abroad. Final assembly and packaging take place in this country.

Although average labor costs in Mexico are lower than in this country, they are significantly higher than in Far Eastern localities and some Caribbean countries.[2] Therefore, an important factor in firms' choosing Mexico to set up manufacturing plants is the proximity to the U.S. consumer market. Plants located in most border cities have easy access to all modes of domestic transportation, and deliveries to most U.S. locations take one day, compared with two days to three weeks from the Far East. Thus, logistical problems and inventory and transportation costs are minimized.

The duty-free zone in which U.S. firms could initially establish in-bond plants in Mexico was a strip 12 miles wide along the northern border. Most plants are still located in the border zone, but the restriction on location was lifted in 1967 to allow in-bond plants in the interior of Mexico.

Although average labor costs in Mexico are lower than in the United States, they are significantly higher than in Far Eastern localities and some Caribbean countries. Therefore, an important factor in firms' choosing Mexico to set up manufacturing plants is the proximity to the U.S. consumer market.

Several restrictions are still imposed on foreign-owned companies operating in Mexico. The Constitution of 1917 prohibits foreign ownership of real estate within 62½ miles of the U.S. border and 31¼ miles of the seacoast. Therefore, most border plants and the land they are located on are owned by Mexican interests and are normally leased to U.S. firms. A small proportion of firms have gained

2. Minimum wages in Mexico vary by economic zone and between agricultural and nonagricultural workers. The highest minimum wage for nonagricultural labor on the U.S.-Mexican border is currently 162 pesos a day ($7.13) in northern Baja California, and the lowest is 115 pesos a day ($5.06) in northeastern Chihuahua, across the border from Presidio, Texas.

more permanent control of their plants through trust agreements sanctioned by the Secretariat of External Relations and entered into with a bank of the Mexican government.

Industrial parks have developed on the Mexican side of the border and have facilitated the growth of the industrialization program. Tenants can rent existing building space or have plants constructed to their own specifications. Manufacturers are allowed to furnish plants with their own equipment.

At least 90 percent of the labor force employed at border plants is required to be Mexican nationals. This requirement causes no problems since the only foreign worker at most plants is the manager.

. . . and a decade of growth

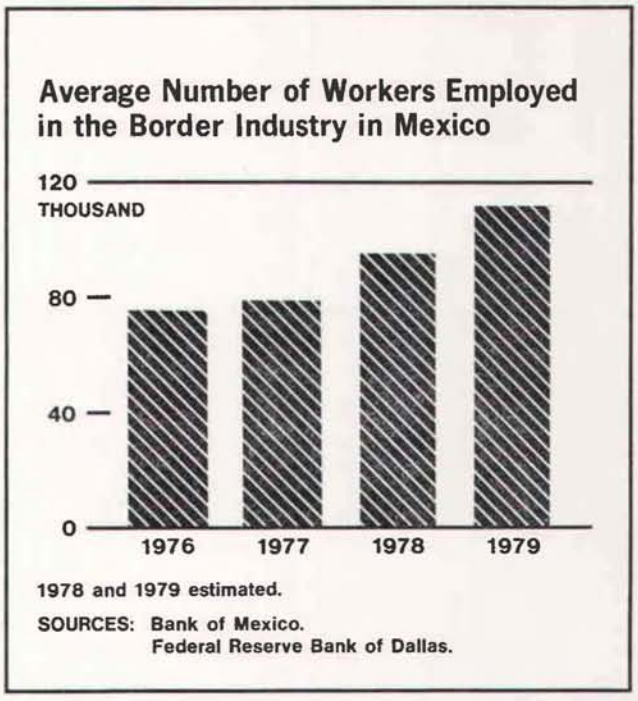
Lower wage rates spurred many labor-intensive industries to participate in the twin-plant program.[3] Electric and electronic products account for about two-thirds of total value added at border plants. That industry group is followed in order of relative importance by shoes and apparel, nonelectrical machinery, furniture and wood products, services, and food products. Nearly 10 percent of total value added is accounted for by various other industries.

By the end of 1965, 12 plants employing over 3,000 workers were operating in Mexican border towns. Investment continued to grow rapidly during the late sixties and early seventies, reaching a peak of 455 plants and almost 76,000 workers in 1974. Value added totaled nearly $316 million.

After ten years of growth, participation faltered. The deepening 1973-75 recession in the United States caused some firms to shut down or cut back their Mexican operations, as well as reduce output at other foreign locations and at home. Employment in the border industries dropped by nearly 9,000 to a total of 67,000 workers in 1975, although value added increased to $321 million.

With the recovery of the U.S. economy from recession, total employment in the border plants rose to more than 78,000 in 1977. The increase, however, occurred mainly at plants that were not affected substantially by the recession. The total number of in-bond plants ebbed to 443.

The decline in the number of border plants from 1975 through 1977 indicated there was little incentive for new firms to enter the program and was related directly to Mexico's accelerated rate of inflation. Consumer prices in Mexico rose at an annual rate of 11 percent in 1973, or double the rate a year before. The rise in prices doubled again to a 23-percent rate in 1974 before slowing to a 17-percent rate in 1975.

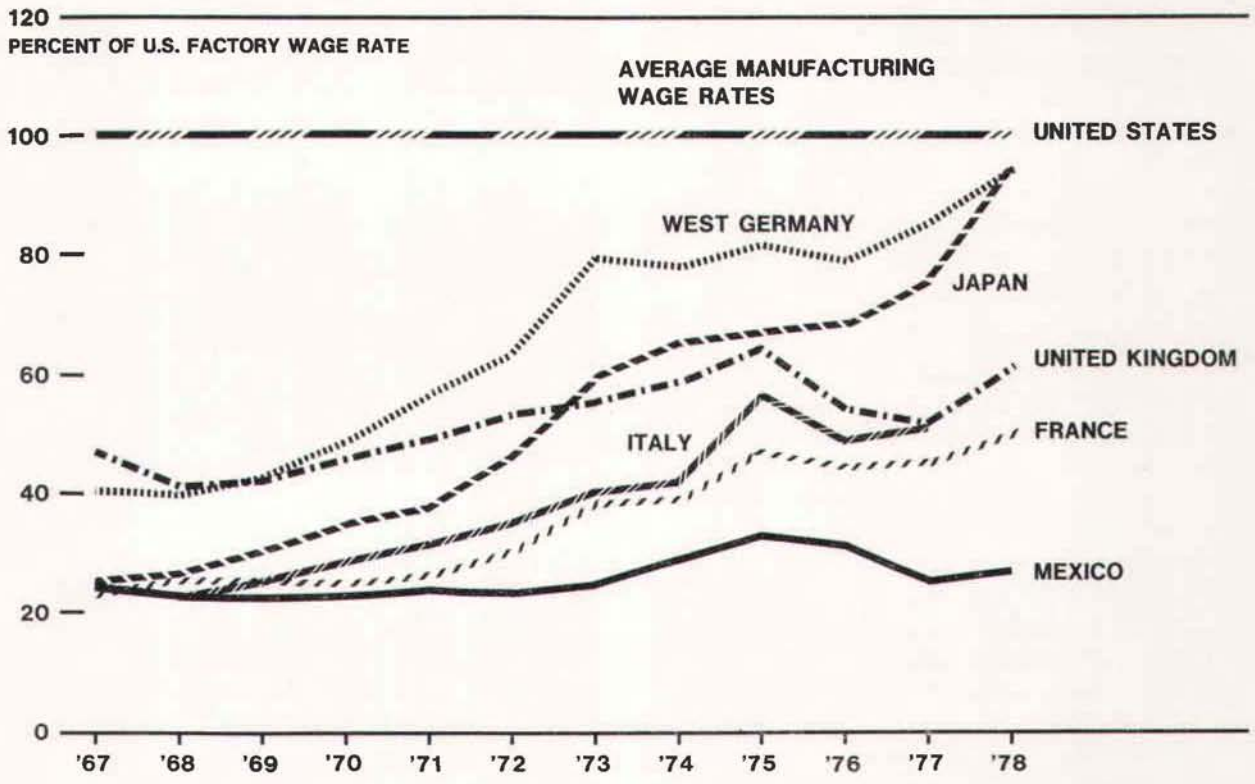


The rapid rise in consumer prices prompted commensurate increases in factory wages. For example, average gross monthly earnings in manufacturing rose from $176 (U.S. dollars) in 1973 to $273 in 1975. That sharp increase raised average labor costs in Mexican factories from about a quarter of the comparable cost in U.S. manufacturing in 1973 to a third of the U.S. equivalent in 1975.

As the relative cost of Mexican labor increased, the competitive advantage tilted to other countries with lower wage rates. Competition for U.S. investment in manufacturing facilities came chiefly from Caribbean and Far Eastern localities—such as the Dominican Republic, Puerto Rico, Hong Kong, South Korea, Singapore, and Taiwan—where increases in labor costs developed less rapidly from 1972 to 1975. In addition, average wage rates in manufacturing in many competing countries were only about 10 percent of the U.S. equivalent. The savings obtained in employing the much cheaper labor more than offset the higher transportation and inventory costs.

3. Although the concept of twin plants suggests two facilities facing each other across the border, the U.S. "twin" is usually a plant located outside the Southwest.

Rising labor costs in major industrial countries have stimulated foreign interest in the border industrialization program . . .



SOURCES: International Monetary Fund.
United Nations.
Federal Reserve Bank of Dallas.

Recovery of the border industry . . .

By last year, economic conditions had changed sharply again, and Mexico had regained its competitive advantage. Total employment in the border industry was estimated at more than 90,000, and value added was over $400 million; but more important, the number of plants along the border was again on the rise as two additions raised the total to 445 last July.

The devaluation of the peso in August 1976 from 8 cents to 5 cents was a major economic move that immediately reduced the cost of Mexican goods and services by 37.5 percent. A further depreciation occurred in October 1976, and the value of the peso subsequently dipped to 4 cents. As a result, payroll costs were halved for U.S. manufacturers operating twin plants. However, workers in Mexico, led by that country's labor unions, demanded and were granted wage increases that partially offset the sharp reduction in payroll costs. Moreover, the value of the peso has drifted upward since the 1976 low and is now about 4.4 cents, but the gap between wage rates in the United States and Mexico has continued to widen.

Average hourly earnings in U.S. manufacturing have increased sharply in recent years. The 28-percent rise in hourly rates from 1975 to 1978 partly reflected cost-of-living increases resulting from the accelerated pace of inflation and the legislated

rise in the minimum wage. Both the peso devaluation and the increase in U.S. factory wage rates caused Mexican wage rates to fall from a third of the U.S. wage equivalent in 1975 to about a quarter last year. That was about the same relative proportion that prevailed in the first ten years of the border industrialization program.

Another factor leading U.S. firms to reconsider setting up manufacturing plants in Mexico was the faster rise in recent years of factory wage rates in the Far East. The average factory wage rate in South Korea last year, for example, was 17 percent of the U.S. equivalent. But even that small proportion has more than doubled since 1970. Manufacturing wages in Taiwan were 14 percent of the U.S. equivalent in 1978 but up sharply from over 7 percent five years earlier. And last year the average factory pay in Hong Kong was 15 percent of the U.S. equivalent, up from 9 percent in 1970. It is mainly those firms that require an extremely large share of labor input in their production processes and do not have to supply large volumes of materials or components to overseas locations, or firms that plan to sell their output fairly close to where it is processed, that find Far Eastern localities profitable places to engage in manufacturing.

Another factor leading U.S. firms to reconsider setting up manufacturing plants in Mexico was the faster rise in recent years of factory wage rates in the Far East.

In contrast to the Far East, the average factory wage in Caribbean countries has not changed much in recent years relative to the U.S. equivalent. Manufacturing wages in Puerto Rico in 1976, for example, were about 53 percent of the U.S. equivalent, and that was barely changed from 52 percent in 1969. The average factory wage in the Dominican Republic has also held steady at about 11 percent of that paid in the United States. But even with relatively low wage rates, transportation costs to the Caribbean make that area unattractive to some industries.

Relatively low wage rates also prevail in South America. For example, factory wage rates in Brazil were 29 percent of the U.S. equivalent in 1976, up from 21 percent in 1972. But locating in South American countries stretches the length of the logistical pipeline and quickly increases the costs of producing goods on that continent for the U.S. market.

. . . and increased foreign participation

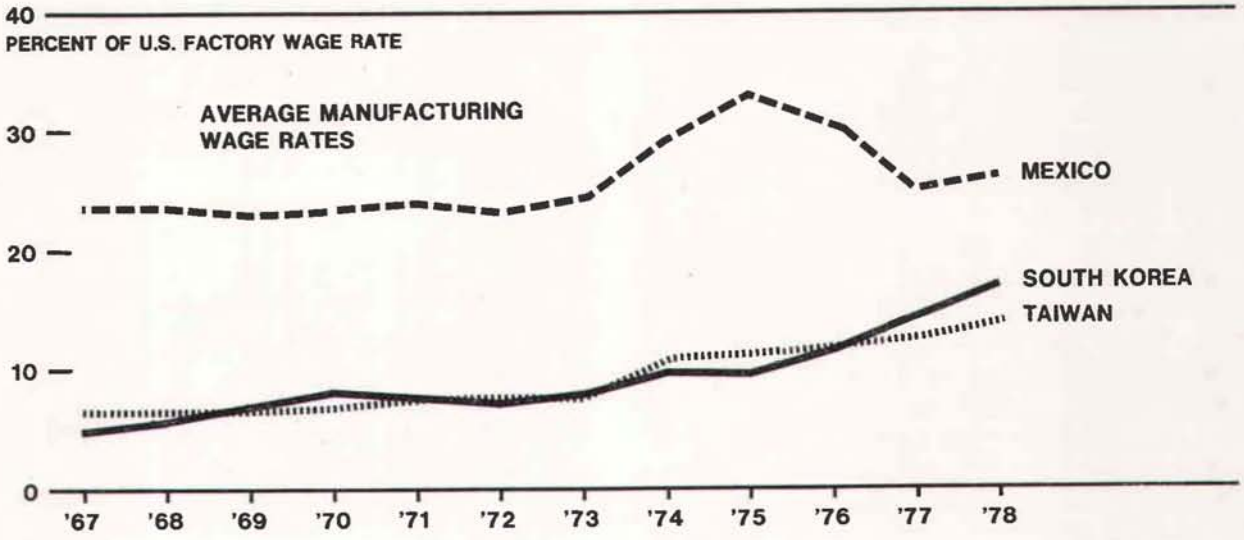
Inflation and rising wage levels have also encouraged labor-intensive industries in countries other than the United States to participate in Mexico's twin-plant program. Foreign companies are moving in because labor costs are low and goods destined for the U.S. market are assembled at our doorstep. But foreign participation is not limited to goods destined for the U.S. market. All the output at some plants is shipped back to the manufacturer's home market, and production at others is sold worldwide.

Inflation and rising wage levels have also encouraged labor-intensive industries in countries other than the United States to participate in Mexico's twin-plant program. Foreign companies are moving in because labor costs are low and goods destined for the U.S. market are assembled at our doorstep.

After the United States, Japan is the biggest participant in the twin-plant program, and Japanese manufacturers have or plan to set up plants in six of the nine largest border towns. Japanese participation has increased because labor costs are rising faster in that country than in other major industrial countries. Measured in U.S. dollars, the wage rate of the average Japanese factory worker last year, for example, was five times higher than in 1970. That sharp rise in wage rates was tempered somewhat by the fast growth in productivity there. Nonetheless, factory pay in Japan was 95 percent of the U.S. equivalent, but much of the difference was, of course, due to the rapid appreciation in the value of the yen relative to the dollar in recent years.

Rising labor costs at home and the proximity to the U.S. market have also stimulated European interest in Mexico's industrialization program. The average manufacturing wage rate in West Germany in 1978, measured in dollars, was 95 percent of the U.S. factory rate. That was nearly double the percentage in 1970. Similarly, wage rates in France, Italy, and the United Kingdom were more than

. . . while some less developed countries are looking to the program as an easy access to the U.S. market



SOURCES: Council for Economic Planning and Development, Republic of China.
International Monetary Fund.
United Nations.
Federal Reserve Bank of Dallas.

half the U.S. equivalent in 1978. But comparable factory wage rates in France and Italy have trended upward fairly steadily since 1970, while the increase in the United Kingdom was slowed in 1976 by the depreciation of the pound sterling.

A Belgian firm is running the only European plant in the border industrialization program at the present time. The plant, located in Ciudad Juarez, manufactures apparel, and all the production is shipped to Belgium. Meanwhile, other Europeans that have investigated the border industrialization program and are currently negotiating to set up plants include the British, French, Germans, Italians, Poles, and Spaniards.

Major industrial countries are not the only countries evaluating the possibilities of establishing manufacturing facilities on the border. Taiwan and South Korea are also interested in producing textiles and electronics at several locations. Even though factory wage rates in those countries are lower than in Mexico, locating on the border facilitates easy access to the U.S. market.

Future of twin plants

The strength of the U.S. economy will continue to be the determining factor as to how well the border industrialization program performs. The mild economic recession that is forecast by many observers for later this year, if it were to materialize, probably would have little effect on the growth of the border industry. Deep recession, however, would be expected to cause layoffs and plant closings, as in 1975.

Increased participation by foreign firms producing goods for their home markets and worldwide distribution should be a stabilizing influence on the overall development of the border industry, assuming the economies of Japan and Western Europe do not rise and fall in synchronization with the U.S. economy, as occurred in 1974-75. At those times when the U.S. economy slips into recession, an increase in output by foreign-operated plants could offset losses in production at U.S. plants. The reverse could occur—a recovery in the U.S. economy and a softening in foreign economies.

The future of the border industry will also depend on the relative rates of inflation in Mexico and the United States. In the past three years, consumer prices in Mexico rose 15.1, 29.0, and 17.5 percent, respectively, on a year-to-year basis, or considerably faster than comparable increases of 5.8, 6.5, and 7.7 percent in the U.S. consumer price index. A continuation of such high rates of inflation compared with those experienced in this country could lead to higher labor costs in Mexico as wage rates rise to reflect the increased cost of living, again discouraging participation in the border industry by U.S. firms.

Because the border industry is a major economic program of the Mexican government, it is not likely the monetary authorities would allow the relative cost of labor to rise so far that investment in twin plants would be discouraged, as in the 1973-75 period. When the peso was devalued in 1976, the exchange rate was moved from a fixed rate to a floating rate. Therefore, if the rise in consumer prices in Mexico persists relative to inflation in the United States, Mexican authorities would likely permit the peso to decline against the dollar, thus maintaining the favorable cost-of-labor relationship.

In a longer view, development and sale of Mexico's large reserves of crude oil and natural gas could put upward pressure on the value of the peso and undermine the twin-plant program by increasing relative wage rates. However, substantial exports of Mexican oil and gas will not likely take place before the mideighties, and it is not clear at this time how much effect such sales will have on the value of the peso. Past experience of other oil-exporting countries suggests little upward pressure has been exerted on the value of their currencies. For example, revenues from petroleum exports in Venezuela, which is a member of the Organization of Petroleum Exporting Countries, have not led to a revaluation of that country's currency.

The outlook for further growth in the border industrialization program, therefore, appears to be bright. The devaluation of the peso in August 1976 reduced the relative cost of Mexican labor to a competitive level, while manufacturing wage rates in most industrial countries and in many less developed countries have been rising faster than in Mexico. As long as Mexico maintains her present competitive position, the border industry is expected to prosper.

New member bank

League City National Bank, League City, Texas, a newly organized institution located in the territory served by the Houston Branch of the Federal Reserve Bank of Dallas, opened for business July 2, 1979, as a member of the Federal Reserve System. The new member bank opened with capital of $625,000 and surplus of $625,000. The officers are: J. W. Lander, Jr., Chairman of the Board; Edwin W. Pugh, President; and Doris Weyer, Vice President and Cashier.

New nonmember bank

First Bank & Trust, Springtown, Texas, a newly organized insured nonmember bank located in the territory served by the Head Office of the Federal Reserve Bank of Dallas, opened for business June 25, 1979.

"Fed Quotes"

Brief Excerpts from Recent Federal Reserve Speeches, Statements, Publications, Etc.

"The Federal Reserve Board for some time has supported the principle of interest payments on transactions balances at all depository institutions. Our support of this principle is based on considerations both of economic equity and efficiency. Corporate depositors as well as some informed smaller depositors already earn something approaching market rates of return on their transactions balances through the implicit receipt of interest in the form of banking services provided at little or no charge. Alternatively, sophisticated depositors are able to minimize their holdings of non-interest bearing deposits by placing their funds in overnight investments that can readily be mobilized for transactions purposes. It is only fair that smaller, less sophisticated depositors have similar opportunities. In addition, since the prohibition against explicit interest payments on transactions balances has led banks to compete on the basis of checking and other services at low or no cost, deposit customers are encouraged to make a greater use of such services than would be the case if they were explicitly priced."

"The Board favors nationwide NOW accounts, authorized for all depository institutions, but limited initially to individuals and nonprofit institutions. Such accounts should be subject to deposit rate ceilings, equal among the institutions, during a transitional period. And the Board strongly believes that all nationwide NOW accounts must be subject to reserve requirements, both because of the importance of the reserve requirement mechanism for the efficient conduct of monetary policy and in the interests of institutional equity."

J. Charles Partee, Member, Board of Governors of the Federal Reserve System (Before the Subcommittee on Financial Institutions Supervision, Regulation and Insurance, U.S. House of Representatives, May 15, 1979)

"The nature of financial markets in this country makes credit controls both unneeded—save for very exceptional circumstances—and extremely difficult to administer. Our credit markets reflect the borrowing and lending decisions of vast numbers of consumers and businesses, and are an important means through which our economic resources are efficiently allocated among competing uses. The market is so large and fluid that credit is generally available to all qualified borrowers, though the price—that is, interest rate—will vary so as to ration the supplies of funds."

Nancy H. Teeters, Member, Board of Governors of the Federal Reserve System (Before the Committee on Banking, Housing and Urban Affairs, U.S. Senate, May 24, 1979)

"In moving to modernize and strengthen our financial system, there are several objectives which are of paramount importance.

"First, the tools for monetary management must be improved. Our present instruments are too blunt to cope adequately with the battle against inflation which threatens our economic well-being. The continuing and accelerating decline in basic deposits subject to central bank reserve requirements has made implementation of monetary policy more uncertain and hence more difficult. It is not that we need more reserves; indeed, less reserves, properly structured, would suffice. But we do need a more certain fulcrum for our monetary lever so that applied action will have a predictable result in the growth or diminution of money and credit.

"Second, there needs to be competitive equality among financial institutions. Free and fair competition is at the heart of our private enterprise system. The present structure places member banks at a competitive disadvantage because of the burdens of non-earning reserves. And there are other inequities that need to be redressed.

"Third, attention should be given to improvement in the mechanism for assuring a sound payments system and appropriate financial liquidity."

"It seems to me that there is growing and widespread accord among the affected constituencies in favor of a Monetary Improvement Program that would encompass the following essential points:

"1. Maintaining the concept of voluntary membership in the Federal Reserve, thus assuring a vigorous dual banking system.

"2. Reducing substantially the amount of non-earning reserves required to be deposited by member banks with the Federal Reserve. Remaining reserve requirements should be uniform as to type of deposit—rather than the present graduated system—and should relate mainly to transactions accounts and their equivalent. This will reduce the financial burden of membership while retaining appropriate reserve levels for monetary control.

"3. At the same time, providing that all financial intermediaries shall maintain reserves with the Federal Reserve with respect to their transactions accounts—on the same basis as member banks. Such universal reserves on deposits related to the basic money supply will provide the fulcrum for effective monetary control and will assure greater competitive equality among depository institutions.

"4. Instituting a policy of explicit charges for most Federal Reserve services—rather than the present system of providing such services without any specific charges. Prices should be based on full costs and an appropriate return on employed capital, with due regard to competitive factors. This will contribute to more efficient payment and other services, more opportunities for the private sector to provide the services, yet assure that a safe clearance system is always available.

"5. Opening up access to borrowing from the Federal Reserve discount window and access to Federal Reserve services to all financial institutions subject to reserve requirements—non-members as well as members. This will provide assurance of the liquidity necessary to keep the financial system working smoothly in time of adjustment or stress."

G. William Miller, Chairman, Board of Governors of the Federal Reserve System (At Columbia University, New York, New York, May 7, 1979)

Mortgage Lending Activity to Benefit from the New Usury Ceiling in Texas

By Charles N. Walush

The Texas Legislature's recent substitution of a floating ceiling for the 10-percent usury ceiling on residential mortgage interest rates should improve the supply of mortgage credit. Prospective home buyers face higher mortgage rates, however, and lending activity may not fully recover to the strong levels of mid-1978. Lenders may face many of the same problems with the new floating ceiling that they encountered with the fixed-rate ceiling.

The 10-percent usury ceiling, in effect in Texas since 1891, has caused problems for mortgage lenders since the latter part of 1978, when mortgage interest rates began to rise above 10 percent in many areas of the country. Mortgage lenders began diverting funds to alternative investments earning higher yields. In addition, the flow of funds to Texas from credit-surplus areas began to slow. The supply of mortgage credit was reduced substantially as a result, and Texas borrowers faced difficulty in obtaining conventional mortgage credit, often getting it only by making large down payments. In the first four months of 1979, the volume of loans closed at insured savings and loan associations (S&L's) in Texas was 24.5 percent below the level a year earlier.

New usury ceiling to follow market rates . . .

The new Texas usury ceiling on mortgage interest rates on one- to four-family residences goes into effect August 28. The new usury ceiling will float 2 percentage points above the rate on ten-year U.S. Treasury notes and bonds, adjusted to constant maturities, and will be rounded to the nearest quarter of a percentage point, up to a maximum rate of 12 percent. Based on the bond rate that prevails two months before the lender becomes legally bound to make the loan, the ceiling would be the maximum interest rate permitted for mortgages. For example, the adjusted ten-year Treasury bond rate was 9.18 percent in April, making the hypothetical usury rate 11.25 percent for June. The new statute will be in effect until September 1, 1981, at which time the interest rate ceiling will once again become 10 percent.

Fifteen other states have already adopted a floating usury rate limit on residential mortgages. Seven of them set the ceiling $1^1/_2$ to $2^1/_2$ percentage points above the interest rates on long-term U.S. Government bonds and notes. Four states set a ceiling 3 to 5 percentage points above the Federal Reserve discount rate. The other states with floating usury

ceilings use the prime rate at banks, rates on three- to five-year U.S. Government securities, or the Federal National Mortgage Association auction rate on conventional mortgages as the base on which the usury ceiling is floated.

The primary advantage of a floating ceiling is that it follows changing market conditions. A floating ceiling set too low, however, will have the same effect as fixed-rate ceilings during periods when market interest rates are above the ceilings. In recent years, mortgage interest rates have rarely risen over 2 percentage points above the adjusted ten-year Treasury bond rate. In April the average effective interest rate on mortgage loans closed on previously occupied homes in the United States was 10.54 percent, while the adjusted ten-year Treasury bond rate was 9.18 percent. Effective interest rates in April averaged 10.33 percent in Dallas-Fort Worth and 10.22 percent in Houston-Galveston.[1] Mortgage rates quoted in April to prospective home buyers in some areas where usury ceilings were not binding were as high as 11.75 percent.

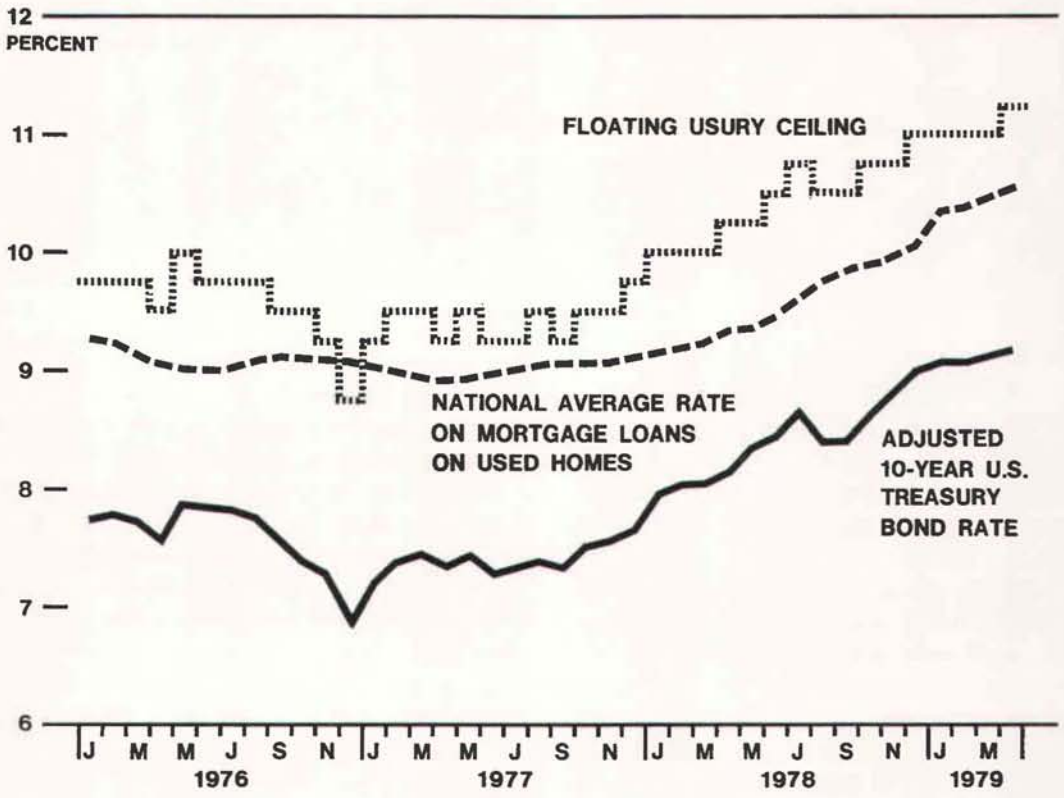
Problems may still arise even with the new floating ceiling. During a period of rapidly rising long-term interest rates, the use of Treasury bond and note rates from two months earlier to set the current month's usury ceiling may limit the rise of mortgage interest rates. In addition, the 2-percentage-point float above the adjusted ten-year Treasury bond rate may actually prove to be too small in coming months. If economic activity begins to lag, savings inflows to S&L's may slow, forcing mortgage rates still higher. But a slowdown in economic activity may ease upward pressure on Treasury bond rates. Under these conditions, mortgage rates in Texas may then press against the floating ceiling.

. . . improving the availability of credit . . .

If the new floating ceiling permits lenders in Texas to charge mortgage interest rates competitive with those in other areas of the country, the availability of mortgage credit in the state will be substantially improved. The funds to make these mortgage loans may come from a reduction in the growth rate of

1. Many mortgage lenders in Texas have charged fees to the seller of the house as an alternative to charging the home buyer a mortgage rate above 10 percent. The fees paid by the seller are included in the calculation of the effective interest rate.

Mortgage rates on loans closed would not have been restricted by a usury ceiling linked to the 10-year Treasury bond rate



NOTE: Effective August 28, 1979, the usury ceiling in Texas is to be 2 percentage points above the 10-year bond rate adjusted to constant maturities.

SOURCES: Board of Governors, Federal Reserve System.
Federal Home Loan Bank Board.
Federal Reserve Bank of Dallas.

Mortgage lending activity down at savings and loan associations in most Eleventh District states

(Dollar amounts in millions)

Activity and state	January-April 1977	January-April 1978	January-April 1979p	Percent changes 4 months 1978 from 1977	Percent changes 4 months 1979 from 1978
Loans closed for purchases of single-family homes					
Louisiana	$ 168.4	$ 233.9	$ 167.9	38.9	-28.2
New Mexico	76.3	103.6	130.9	35.8	26.4
Oklahoma	190.7	207.7	167.7	8.9	-19.3
Texas	1,096.2	1,401.4	1,058.6	27.8	-24.5
New commitments to originate loans					
Louisiana	416.2	487.8	321.5	17.2	-34.1
New Mexico	145.0	157.7	140.2	8.8	-11.1
Oklahoma	300.2	272.0	244.3	-9.4	-10.2
Texas	2,103.6	2,271.9	1,553.0	8.0	-31.6

p—Preliminary.
SOURCES: Federal Home Loan Bank of Little Rock.
Federal Home Loan Bank of Topeka.

cash and investment holdings as well as an increase in sales of mortgages in the secondary market.

Savings and loan associations in Texas have indicated that they bought short-term investments, such as bankers acceptances and bank certificates of deposit, as alternatives to lending the funds as mortgages. Cash and investment holdings at Texas S&L's grew faster during the past year than in the preceding year, and the rate exceeded the growth rate of total assets. Cash and investment holdings of Texas S&L's averaged $2,401 million a month in the first four months of 1979, or 26.1 percent higher than in the same period in 1978. Some of the growth in cash and investment holdings reflects the increased need of S&L's to hold reserves against the money market certificates they issue. The funds that have gone into reserves against money market certificates are not likely to be released for additional mortgage lending activity.

The growth of the Texas economy has created a need for credit greater than can be provided locally. By selling locally made mortgages in the secondary market, lenders are able to obtain funds to make additional mortgages. But originators of conventional mortgages in Texas have found it difficult to sell mortgages in the secondary market in recent months. Sales of loans by Texas S&L's in the first four months of this year were 34.6 percent below a year earlier. When mortgage lenders are relieved from the 10-percent usury ceiling in late August, Texas-originated mortgages will be more salable in the secondary market if their yields rise to competitive levels.

One problem that may face S&L's is a slowdown in savings growth. Savings and loan associations experienced net withdrawals in April, perhaps foreshadowing a slowdown in deposit inflows in coming months. Some of the April loss in deposits was caused by savers withdrawing funds to pay taxes. But the elimination of the 1/4-percentage-point advantage of S&L's over commercial banks on the rate they can pay on money market certificates also appears to be taking its toll of savings inflows at S&L's. Should savings inflows continue weak in coming months, further upward pressure on mortgage interest rates can be expected.

If the floating ceiling keeps mortgage rates in Texas from rising to competitive levels, mortgage lenders will face many of the same problems they encountered with the 10-percent ceiling. The ceiling rate will be about 11 percent in September, which is below rates in areas where mortgage lending activity has not been affected by usury ceilings. The amount of improvement in the salability of

Texas mortgages in the secondary market will largely depend on how close mortgage rates in Texas come to those prevailing nationally.

. . . but prospective home buyers face higher mortgage interest rates

Mortgage interest rates in Texas are likely to rise following the lifting of the 10-percent ceiling. In some areas of the country where mortgage rates have risen above 10 percent, lenders have experienced declines in mortgage lending activity.

Oklahoma currently has a usury ceiling of 18 percent on residential mortgages, and mortgage rates are generally between 10.5 percent and 11.0 percent. Although the supply problem caused by a binding usury ceiling has not affected Oklahoma as it has Texas, both states have experienced similar declines in mortgage lending activity. Mortgage loans closed at S&L's in the first four months of this year were 19.3 percent below last year's level in Oklahoma and down 24.5 percent in Texas.

Effective mortgage interest rates in Louisiana are also above 10 percent, and mortgage loans closed were 28.2 percent lower than in the first four months of 1978. Although Louisiana statutes place a 10-percent limit on the interest rate lenders may charge, lenders are permitted to charge fees that raise the effective mortgage rate above 10 percent. These fees inflict a hardship on borrowers since they raise the initial payments borrowers must meet.

Exemption from New Mexico's 10-percent usury ceiling of loans sold to the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation has helped mortgage lenders in that state avoid some of the problems of usury ceilings. Loan sales in the first four months of this year totaled $86 million, 179 percent above a year earlier, indicating that this exemption has been used frequently. In addition, state and municipal mortgage finance authorities have given support to mortgage lending activity. Mortgage loans closed in New Mexico were 26.4 percent more than in the first four months of 1978.

The effects of the 10-percent usury ceiling on lending activity in Texas are probably somewhat understated by the mortgage loan closing figure. Some of the loans closed represented takedowns of commitments made before mortgage rates averaged above 10 percent nationally. New commitments in the first four months of 1979 were 31.6 percent below a year earlier in Texas, compared with an 11.1-percent decline in New Mexico and a 10.2-percent decline in Oklahoma. Louisiana also had a large decline; new commitments fell 34.1 percent in that state.

Mortgage interest rates in Texas will be higher with the new usury ceiling than with the 10-percent ceiling, and lending activity is likely to increase. The rise in mortgage rates will help to improve the supply of mortgage credit by increasing the salability of Texas mortgages in the secondary market and will encourage lenders to devote more of their own funds to mortgage lending. But with mortgage rates approaching 11.75 percent in some areas of the country, the new floating usury ceiling may only prove to be somewhat less restrictive than the 10-percent usury ceiling.

Handling of Checklike Payment Instruments Studied by the Fed

Payment instruments drawn on savings accounts at mutual savings banks are currently being processed through the Federal Reserve check collection system. This practice has been challenged by various trade organizations. The Board of Governors of the Federal Reserve System asked on April 23, 1979, for public comments and is now reviewing the comments received on both this procedure and a proposal by the Federal Home Loan Bank Board to allow savings and loan associations to issue checklike instruments.

The checklike instruments concerned are:

- Non-interest-bearing negotiable orders of withdrawal (known as NINOW's) that the state of Pennsylvania has authorized to be drawn on accounts at mutual savings banks in that state.
- Other similar payment instruments, including Payment Orders of Withdrawal proposed by the Federal Home Loan Bank Board to be drawn on accounts at savings and loan associations.

The NINOW's were authorized by the Pennsylvania Secretary of Banking in 1977. They have certain characteristics of checks, in that they may be cashed, used for purchases, or endorsed to other recipients. However, it must be stated on the face of the instruments that the mutual savings bank on which they are drawn reserves the right to delay payment for at least 14 days. Because of this requirement, the Pennsylvania Supreme Court ruled that NINOW's are not payable on demand and are not checks as defined by the Uniform Commercial Code. The decision placed NINOW's outside the definition of "cash item" as specified in the Board's Regulation J, which governs the Federal Reserve's payments system activities.

The Federal Reserve has been handling NINOW's as cash items since their inception. In view of the Pennsylvania Supreme Court decision, the Board has sought the advice and comment of the public on whether to continue processing such instruments as though they were checks.

In November 1978 the Federal Home Loan Bank Board asked for public comment on a proposal that would allow savings and loan associations under its jurisdiction to establish savings accounts against which their customers could write checklike Payment Orders of Withdrawal. The proposed Payment Orders would be payable on demand and would be nontransferable and nonnegotiable. Third-party payments made with instruments that are not transferable raise legal questions as to the rights and liabilities of subsequent holders of such instruments. The Board has requested comments on possible consumer benefits of Payment Orders, as well as on the legal questions arising from the use of the instruments.

Comments received from Eleventh Federal Reserve District banks have generally opposed the practice of clearing checklike instruments of nonbank institutions through the Federal Reserve check collection system. Reasons given for the opposition included the contention that mutual savings banks and savings and loan associations are not banks and, therefore, should not be entitled to act as banks or use Federal Reserve services. Other problems with these items that were often mentioned were increased float and collection time. Banks believed that the items could more appropriately be handled on a collection, rather than cash, basis. Banks also believed that the cost and delay involved in handling these checklike instruments would have to be passed on to the customer.

Energy and the Outlook for Cotton Producers

By Larry D. Hauschen

Cotton is an important crop in the agricultural economy of the Eleventh Federal Reserve District. Texas, with $1.3 billion of cotton in 1977, is the largest producer of upland cotton and the second largest producer of American-Pima cotton in the nation. Louisiana, New Mexico, and Oklahoma—the other District states—rank 6th, 7th, and 11th, respectively, among states producing upland cotton, and New Mexico is the 3rd largest producer of American-Pima cotton. The importance of cotton gives rise to concern regarding the effects of increasing energy prices on District cotton producers.

Trends in cotton production

With the exception of Louisiana, the Eleventh District states have not always been so important in the nation's production of cotton. Rather, there has been a steady westward shift in U.S. cotton production. In 1839 the Deep South states of Alabama, Georgia, Louisiana, Mississippi, North Carolina, and South Carolina produced 94 percent of U.S. cotton, while Arizona, California, Oklahoma, New Mexico, and Texas produced virtually none. (See the accompanying table.) Ten years later, Texas produced over 2 percent of the U.S. crop, and by 1900, Texas farmers had increased their state's share of total output to 33 percent. Oklahoma first appeared in the cotton production statistics in 1879, followed by Arizona and California around 1915 and New Mexico in 1923.

By 1940, cotton production in the six Deep South states had fallen to 41 percent of U.S. output. The shift continued until by 1977 the Deep South states produced less than 20 percent of U.S. cotton, with the four states of Alabama, Georgia, North Carolina, and South Carolina producing less than 4 percent. Texas alone produced more than 38 percent of total output that year, and Arizona, California, New Mexico, and Texas combined produced over 66 percent of the nation's cotton.

The westward shift was apparent even within Texas. In the 1800's, cotton production in Texas was centered in the Blacklands and eastern areas of the state. Today, partially because of the development of irrigation technology, cotton production in the state is heavily concentrated in the Southern High Plains of western Texas.

Farm energy use in cotton production

The shift in cotton production to states relying heavily on irrigation, which is a heavy user of energy, suggests that the importance of energy inputs in the production of cotton has increased. With rapidly rising energy prices, the irrigated areas may lose some of their advantage over other areas. The ability of farmers in the southwestern states to continue to earn acceptable rates of re-

COTTON PRODUCTION IN 14 LEADING STATES AS PERCENTAGE OF U.S. TOTAL

Area	1839	1900	1940	1970	1977
Eleventh District states					
Louisiana	19.3	7.0	3.6	5.1	4.6
New Mexico	.0	.0	1.0	1.3	1.1
Oklahoma	.0	3.4	6.4	1.9	3.1
Texas	.0	32.9	25.7	31.5	38.3
Other leading states					
Alabama	14.8	10.1	6.2	5.0	1.9
Arizona	.0	.0	1.6	4.6	7.5
Arkansas	.7	7.9	11.9	10.3	7.3
California	.0	.0	4.3	11.4	19.5
Georgia	20.7	12.4	8.0	2.9	.6
Mississippi	24.5	10.4	9.9	16.1	11.5
Missouri	.1	.3	3.1	2.2	1.6
North Carolina	6.6	5.0	5.9	1.5	.4
South Carolina	7.8	7.7	7.7	2.1	.8
Tennessee	3.5	2.2	4.1	3.9	1.8

SOURCES: U.S. Bureau of the Census.
U.S. Department of Agriculture.

turn to area resources in cotton production will depend, in part, on the energy intensiveness of their production relative to production in other states.

To explore the level of energy use in cotton production, two measures of energy intensiveness have been calculated for each of the 14 leading cotton-producing states: Btu (British thermal unit) use per planted acre and Btu use per pound of cotton. The 14 states account for virtually all the U.S. cotton. Total energy use by the states is divided into two categories: direct—used directly in producing cotton—and indirect—used in the manufacture of fertilizers and pesticides that in turn are used in producing cotton.[1]

New Mexico and Arizona use 2 1/2 times as much energy per acre as any of the other states (Chart 1). Texas, on the other hand, uses less energy per acre than ten states, and Oklahoma uses less than any other state.

In terms of energy use per pound of cotton produced, New Mexico is the most energy-intensive state (Chart 2). However, because of higher yields, Arizona uses less than half as much energy per pound as New Mexico, even though the two states use almost the same amount per acre. Texas is the second most energy-intensive, using slightly more than 30,000 Btu per pound, and California is the least energy-intensive, using only 12,000 Btu per pound. Although a substantial difference exists between California and New Mexico, the least and most energy-intensive states, all other states use between 20,000 and 30,200 Btu per pound of cotton. Since the heavily irrigated western states accounting for the majority of the nation's cotton do not use significantly larger quantities of energy than other states, there is no reason to expect rising energy prices to reverse the westward shift in cotton production.

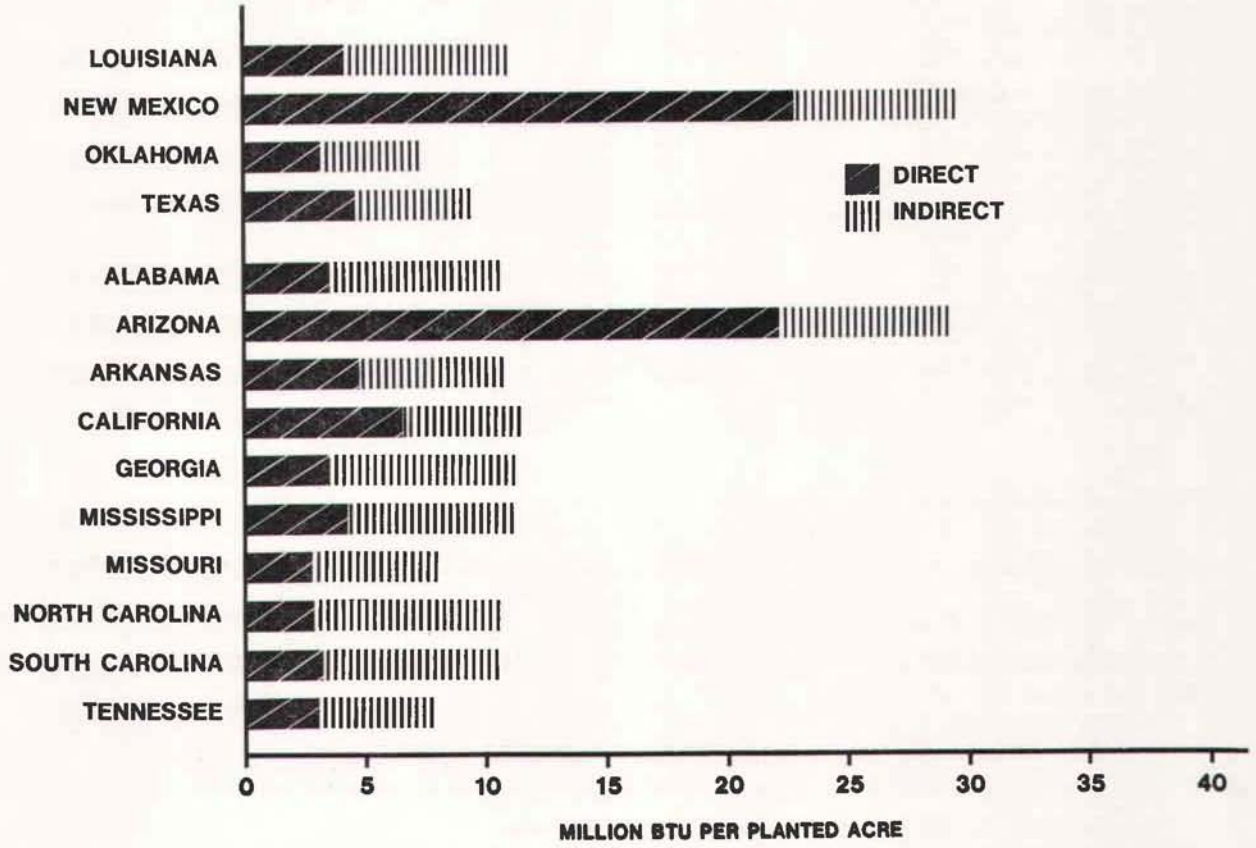
The future for cotton production

Rising energy prices will make cotton a less profitable crop for farmers if energy prices increase relative to cotton prices. The demand for cotton and, therefore, cotton prices are strongly influenced by prices of synthetic fibers that can be substituted for cotton in the manufacture of clothing and other items. Polyester, cotton's most important substitute, was first available commercially in 1953. In 1960 the quantity of polyester produced was only 2.8 percent by weight of cotton production. By 1970, that ratio had increased to 38 percent, and in 1977, more polyester was produced than any

1. For more information on the energy-use measures and implications of rising energy prices for District agriculture, see Larry D. Hauschen, "Energy and the Outlook for Agriculture in the Southwest," *Voice of the Federal Reserve Bank of Dallas*, May 1979.

CHART 1

New Mexico and Arizona use 2½ times more energy per acre of cotton than any of the other states



SOURCE: *Energy and U.S. Agriculture: 1974 Data Base* (Federal Energy Administration and U.S. Department of Agriculture).

other fiber (113 percent of cotton production). However, the cost of producing synthetic fibers, such as polyester, is also highly susceptible to increases in energy prices since these fibers are manufactured from petroleum.

This is cited as cause for optimism among cotton producers. The National Cotton Council published a study in 1973 showing that polyester fiber requires five times as much energy to produce as cotton fiber.[2] This would imply that increases in petroleum prices will raise prices of synthetic fibers relative to cotton.

Recently, a more comprehensive study has drawn different conclusions.[3] This study estimated total energy consumption for synthetics and cotton—from the drilling of oil in the case of synthetics and the preparation of land in the case of cotton to the production of the fiber, weaving of the cloth, and manufacture of the apparel plus the washing, drying, and ironing throughout the life of the apparel. The study chose to make this comprehensive com-

2. L. B. Gatewood, Jr., *The Energy Crisis: Can Cotton Help Meet It?* (Memphis: National Cotton Council of America).

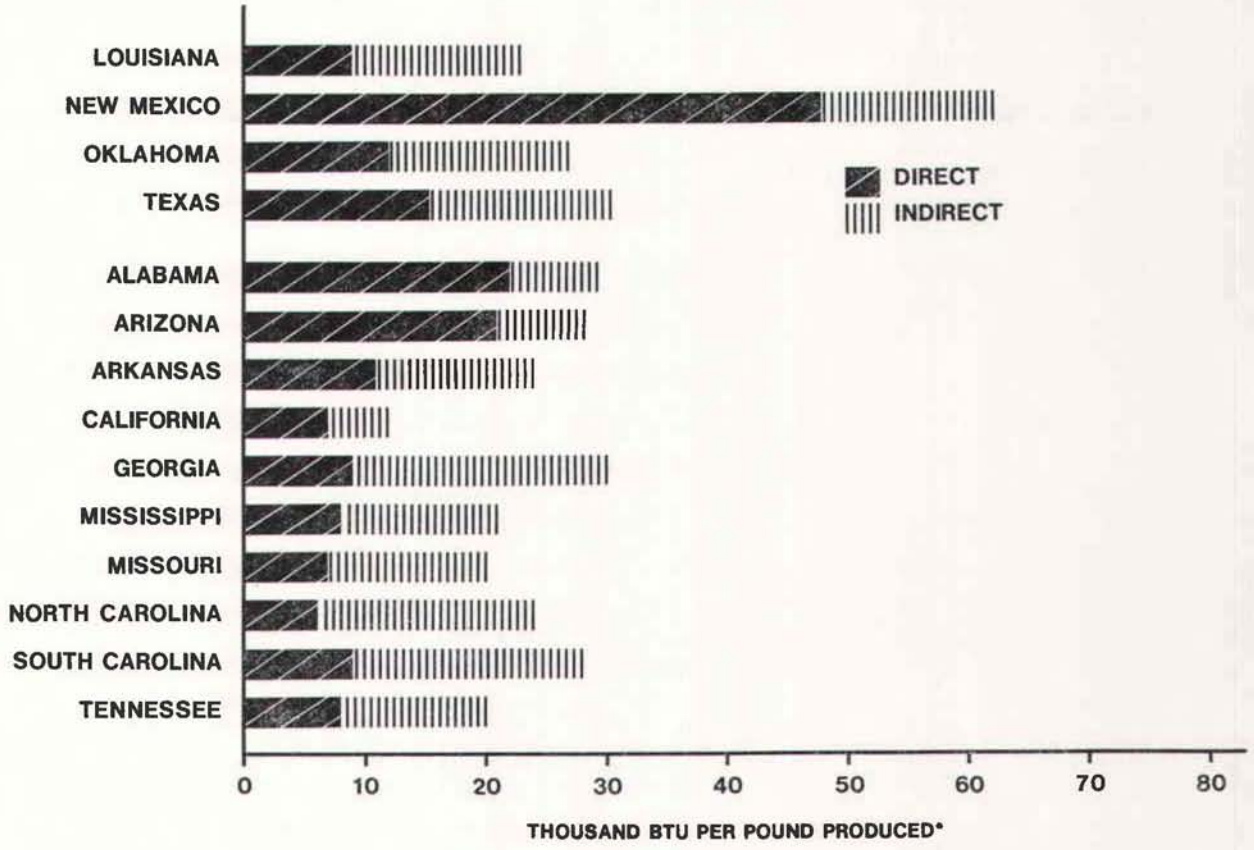
3. T. Leo van Winkle et al., "Cotton Versus Polyester," *American Scientist* 66 (May-June 1978): 280-90.

parison between an all-cotton shirt and a 65 percent polyester-35 percent cotton blend shirt. The polyester-cotton shirt, it was found, required 25 percent more total energy to produce than the all-cotton shirt. However, given a laundering pattern considered most closely representing U.S. practices, it was found that the blend shirt needed less time and lower temperatures for washing and drying and, in addition, had a longer wear life—leading to the conclusion that the all-cotton shirt required 88 percent more energy than the 65-35 polyester-cotton shirt.

The cotton-synthetic energy question has, nevertheless, not been decisively answered. Although question exists as to the extent of the difference, it is clear that the production of cotton cloth and cotton apparel requires less energy than production of their synthetic counterparts. The Van Winkle study found that only when laundering and wear life were considered did the synthetic use less energy. Given that, a couple of questions seem appropriate. One, are men's dress shirts representative of textile end use and, therefore, a good choice for the comparison? Men's shirts account for only

CHART 2

Twelve states use between 20,000 and 30,200 Btu per pound of cotton produced



* Based on 1970-77 average yields per harvested acre and proportions of planted acres harvested of both upland and American-Pima cotton.

SOURCE: *Energy and U.S. Agriculture: 1974 Data Base* (Federal Energy Administration and U.S. Department of Agriculture).

six-tenths of 1 percent of total U.S. fiber consumption. In fact, less than half of U.S. mill fiber production is consumed by the entire apparel industry. Almost 32 percent is used in homefurnishings, and nearly 23 percent goes to industrial uses. In both instances, energy in laundering is less important. This indicates that, in fact, a man's dress shirt is not an appropriate choice for comparison of energy use. A better inquiry might compare energy use in terms of some "weighted basket" of textile end uses.

One might also question the validity of comparison throughout the life of a garment. That is, the effective life of a shirt or other apparel as perceived by the consumer is probably quite different from the length of time required for the garment to be literally worn out.

In the final analysis, the need for less energy to produce cotton fiber, the questionable importance of durability as it relates to energy use, a possible "natural preference" for cotton by consumers, and technological developments (such as the permanent-press cotton shirt) suggest that cotton producers may well have cause for optimism. This does not suggest that rising energy prices will have no impact on cotton producers. An increase in energy prices will lead to adjustments, particularly in the most energy-intensive states and by the most energy-intensive users within a state. Adjustments may include reduced application of water to cotton acreage, more efficient methods of applying water, increased monitoring of pumping equipment, and reductions in the amount of tillage.

Overall, these adjustments may be greatest in New Mexico, where cotton farmers use more energy than in any other state. Texas farmers, on average, are not significantly more energy-intensive than farmers in most other cotton-producing states and, although some adjustments will be necessary, should be able to continue to produce cotton efficiently enough during a period of rising energy prices to maintain, if not increase, the state's share of the nation's cotton production.

Regulatory Briefs

Review of Recent Actions of the Board of Governors of the Federal Reserve System

• **HIGHER RETURNS ON SMALL DEPOSITS** have been permitted by recent regulatory changes jointly announced by the Federal Deposit Insurance Corporation, the Federal Reserve Board, and the Federal Home Loan Bank Board. The changes went into effect on July 1 for all federally insured commercial banks, savings and loan associations, and mutual savings banks.

The changes are:

1. An increase of one-quarter of 1 percent in the maximum rate of interest that commercial banks and thrift institutions may pay on passbook savings accounts. This will raise the ceiling to 5¼ percent for commercial banks and to 5½ percent for savings and loan associations and mutual savings banks. The ceiling rate on NOW (negotiable orders of withdrawal) accounts in New England and New York will remain at 5 percent for all depository institutions.

2. A new savings certificate with a maturity of four years or more that will have a ceiling rate tied to the average four-year yield for U.S. Treasury securities as determined each month by the Treasury Department. The ceiling for commercial banks will be 1¼ percent below the average four-year yield on Treasury securities, while the ceiling for thrift institutions will be 1 percent below the yield.

3. Elimination of all minimum-denomination requirements on consumer-type time deposits except for the $10,000 minimum required for 26-week money market certificates. Institutions may set their own minimums if they wish.

4. A new early-withdrawal penalty in all time deposit categories for certificates issued or renewed after July 1. If deposits mature in more than one year, the minimum penalty will be six months' loss of interest. If the deposits mature in one year or less, the minimum penalty will be three months' loss of interest. The penalty rule requiring reduction of the rate of interest paid on the funds withdrawn to the passbook savings rate, plus a loss of three months' interest at that rate, will continue to apply to all certificates issued before July 1.

The regulatory agencies plan to consult at the end of the year to discuss further adjustments in interest rate ceilings that might be appropriate.

The ceiling rate for the new certificate will change on the first calendar day of each month, based on the average four-year yield on Treasury securities as determined and announced by the Treasury Department. This yield will be announced three business days prior to the first day of the month and will be the average of the four-year yields for the preceding five business days. Thus, the ceiling rate in effect beginning July 1—7.60 percent—was announced by the Treasury on June 27, based on the average of the four-year yields for June 20 through June 26.

The new variable-rate-ceiling certificate does not replace the existing fixed-ceiling time deposits with maturities of four, six, or eight years. Current ceilings on these deposits will remain in effect.

• **ELECTRONIC FUND TRANSFER ACT IMPLEMENTATION RULES** are being revised by the Federal Reserve Board. The public comment period on the proposed revisions expired June 25. The proposal would make written notice of loss or theft of an EFT card effective when the consumer mails or otherwise transmits the notice.

This proposal would revise the portion of Regulation E, published March 21, that provided that written notice of loss or theft of an EFT card would be effective upon receipt of the notice by the financial institution concerned or upon expiration of the normal time for delivery, whichever is earlier.

The Board believes that the proposed amendment would assist consumers who promptly notify the financial institution of loss or theft of an EFT card to receive full benefit of the $50 limit on potential liability provided by Congress for unauthorized use of EFT cards. The proposal would help consumers avoid loss of this protection due to delays in the delivery of mail or other delays in delivery of written notice. The Electronic Fund Transfer Act currently provides for a consumer liability limit of $50 when notice of loss, theft, or unautho-

rized use of an EFT card is provided to financial institutions within two business days. Regulation E states that notice can also be given orally, by telephone or in person.

Consumer liability for unauthorized use of an EFT card is limited to $50 if the consumer notifies the card issuer within two days of learning of the loss or theft of the card or its unauthorized use. Potential liability increases to $500 if notification occurs after two business days. In case the consumer fails to notify the card issuer within 60 days after transmittal of a periodic statement showing unauthorized use of the EFT card, the consumer's liability may be unlimited for transfers made after the 60 days.