Using The Futures Markets To Hedge
Recent Changes in Fifth District SMSA's
The Household Worker
USING THE FUTURES MARKET TO HEDGE
Some Basic Concepts

In the United States organized trading in commodity futures began in Chicago more than 100 years ago. Today there are 20 licensed exchanges in the United States and an even larger number abroad. There has been an increasing awareness of the futures markets on the part of businessmen and the general public in recent years. This interest has been reflected in substantial year-to-year increases in the number and value of transactions on the nation’s commodity exchanges. Trading activity in 1972 was more than three times the level 10 years earlier. Agricultural products dominate the long list of commodities traded, but there is also an active market for such commodities as silver, propane gas, and copper. In 1972 soybeans were the most actively traded commodity, followed by frozen pork bellies.

The recent growing interest in the futures markets is likely to accelerate, particularly on the part of agribusiness firms. These firms are relying increasingly on borrowed capital, and by using the futures markets to hedge, both borrowers and lenders can protect themselves against risks of commodity price changes. Moreover, the benefits of hedging are likely to become more obvious to those who deal in agricultural commodities as Government stocks decline. In recent months Government grain stocks have dwindled to almost nothing. As long as Government stocks are low or nonexistent, prices of grains and other commodities likely will be much more volatile as supply-demand conditions change. Consequently, managers will probably turn to the commodity futures markets more frequently as they seek to hedge their crops and inventories against drastic price changes.

A long history and growing importance notwithstanding, knowledge of the institution of futures trading is not widespread, even among businessmen. This article is designed to acquaint businessmen who might use futures markets in their production, warehousing, and processing activities, and the lenders who finance them, with the basic principles underlying the operation of the futures market.

Major Commodity Exchanges There are five principal commodity exchanges in the United States. The 124-year-old Chicago Board of Trade is by far the largest, accounting for more than one-half of total trading. It lists contracts in corn, wheat, oats, soybeans, soybean oil, soybean meal, plywood, and silver. The Chicago Mercantile Exchange is the second largest exchange. Handling contracts in live cattle, live hogs, frozen pork bellies, lumber, grain sorghum, and Idaho potatoes, this exchange accounts for about 25 percent of total trading. The New York Cotton Exchange lists contracts in frozen orange juice, liquefied propane gas, cotton, and wool. Futures contracts in platinum, boneless beef, Maine potatoes, and silver coins are traded on the New York Mercantile Exchange. The Commodity Exchange in New York provides a marketplace for copper and silver.

The Futures Contract The physical commodity itself is not bought and sold on the futures market. Instead, trading is in contracts for the delivery of a standardized quantity and quality of a commodity at some future date at a designated price. Suppose, for example, that on April 11 an individual decides to buy a contract of December corn that is selling at $1.52 per bushel. The initial step in implementing the transaction is to open an account with a commodity broker who is represented on the exchange where corn is traded. The individual then instructs the broker to buy a contract of December corn. By purchasing the contract he enters into an agreement that calls for him to accept delivery and make payment of $1.52 per bushel for corn in December. In this case, where the trader’s first transaction is a contract to buy, he is said to be long the futures. The
individual who sells the contract agrees to deliver corn in December for a price of $1.52 per bushel. Where the trader’s first transaction is a contract to sell, he is said to be short the futures. The following items are specified in the contract: the commodity, price per unit, quantity, quality or grade, delivery date, place of delivery, and terms of payment. In the case of grain, a standard contract is 5,000 bushels, and the place of delivery is a public warehouse designated by the commodity exchange. In addition to the contract terms, additional regulations are usually imposed.¹

The commodity exchanges establish several delivery months for each commodity. Delivery months are generally tailored to the seasonality of production and to the needs of the buyers and sellers of the particular commodity in question. Delivery months for corn are July, September, December, March, and May. Although some contracts are for periods other than a year, most extend forward up to one year; and when a contract matures it is replaced by a contract for the same month of the following year.

A futures contract may be settled either by delivery or by making an opposite or offsetting transaction in futures. In practice, commodities are actually delivered on only 2 to 3 percent of the futures contracts. Because of the additional costs of making delivery, it is generally more profitable for the seller to offset the futures contract before maturity and deliver his product in the local market. Contracts in the futures market are bought and sold on margin. Margin funds, deposited with a broker by both buyer and seller, usually range from 5 to 10 percent of the value of the contract and serve as performance bond to assure settlement in the event of unfavorable price changes.

¹ For details of these regulations see Thomas A. Hieronymus, Economics of Futures Trading for Commercial and Personal Profit (New York: Commodity Research Bureau, Inc., 1971), p. 94.

---

A FUTURES GLOSSARY

**Basis** The difference between the price of a futures contract and the price of the same or similar commodity in cash transactions.

**Delivery Month** The calendar month during which a futures contract matures.

**Futures Contract** An agreement set forth in standardized terms under rules of an organized commodity exchange to buy and receive, or to sell and deliver, a commodity at a future date.

**Hedging** Using the futures market to reduce exposure to price risk and to help assure profits on business activities.

**Long Position** One in which an individual’s inventory plus forward purchases exceeds his forward sales; also, the buying side of an open futures contract.

**Margin** The amount deposited by a trader with his broker to insure performance on contract commitments.

**Open Interest** The total of unfilled or unsatisfied futures contracts on either side of the market.

**Regulated Commodities** Those regulated by the Commodity Exchange Authority (CEA) under specific provisions of the Commodity Exchange Act. The CEA is concerned with safeguarding futures trading against price manipulation and abusive trading practices.

**Short Position** One in which an individual’s forward sales exceed his inventory plus forward purchases; also, the selling side of an open futures contract.

**Volume of Trading** The total purchases or sales of a commodity future during a specified period.

Futures Quotations

The financial page of most large newspapers usually includes the opening, high, low, and closing price of contracts traded the previous day. These quotations reflect the prices determined by the actions of buyers and sellers represented on the floor of the commodity exchange. Table I shows that the futures trading on April 11, 1973 for March 1974 soybeans resulted in an opening contract of $4.11 per bushel, while transactions made at the close of the market ranged from $4.15 to $4.16 a bushel. An individual who buys a March contract at $4.15 agrees to accept delivery of 5,000 bushels of soybeans at this price at expiration of the contract in March 1974. If he decides not to fulfill this contract by accepting delivery of the soybeans, he may sell a March futures contract prior to the maturity date for the contract. Since the terms of the two contracts offset each other, both contracts are cancelled.

Hedging

Anyone who owns an inventory of a commodity is faced with a speculative risk because the value of the inventory may fall. Businessmen who need to purchase commodities for use in their business are faced with the risk that prices may rise. The futures market provides a means whereby the businessman can transfer the risks to speculators by hedging. Indeed, this is the primary function of the futures market. A hedge is established by taking a position in futures equal to and opposite an existing or anticipated cash position. For example, if an individual has an inventory of 50,000 bushels of soybeans, he is long cash soybeans. If the price of soybeans goes up he gains, if it goes down he loses. He can offset the risk of a price decline by selling 50,000 bushels of soybeans on the futures market. He is now hedged because he is short futures and long cash soybeans. As long as cash and futures prices move up and down together, what he makes on one position he will lose on the other. Consequently, he is unaffected by price changes. When the cash soybeans are sold, the futures contracts are bought and the transaction is completed. The owner (hedger) shifted the price risk of ownership to the purchaser of the futures contracts. The person who assumes a position opposite a hedge position is generally a speculator who hopes to profit from a price change he has correctly anticipated. Speculators are willing to accept the inherent risks because of the opportunities for quick and substantial profits.

Hedging is possible because of the relationship between cash prices and futures prices. Because they reflect the cost of storage, insurance, and interest for the commodity being carried for future delivery, futures prices are generally higher than cash prices. At any given time, however, local supply-demand conditions may be such as to cause the cash price to be higher than the futures price. Normally, cash and futures prices tend to move up and down together. Although most futures contracts are cancelled by the purchase of an opposite contract, the

Table I

<table>
<thead>
<tr>
<th>Month</th>
<th>Open</th>
<th>High</th>
<th>Low</th>
<th>Close</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>1973</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>May</td>
<td>609</td>
<td>619</td>
<td>599</td>
<td>617-618</td>
<td>+ 6 1/4-7 1/4</td>
</tr>
<tr>
<td>July</td>
<td>570</td>
<td>581 1/2</td>
<td>564</td>
<td>579 3/4</td>
<td>+ 6 1/4</td>
</tr>
<tr>
<td>August</td>
<td>538</td>
<td>553</td>
<td>537 1/2</td>
<td>551-551 1/2</td>
<td>+ 5 1/2-6</td>
</tr>
<tr>
<td>September</td>
<td>465</td>
<td>447</td>
<td>464 3/4</td>
<td>475</td>
<td>+ 3 1/3</td>
</tr>
<tr>
<td>November</td>
<td>409</td>
<td>412 1/8</td>
<td>407</td>
<td>412 1/4</td>
<td>+ 1 1/8-1 1/8</td>
</tr>
<tr>
<td>1974</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>January</td>
<td>410</td>
<td>413 1/2</td>
<td>408</td>
<td>413 1/4-413 1/2</td>
<td>+ 1 1/2-1 3/4</td>
</tr>
<tr>
<td>March</td>
<td>411</td>
<td>416 1/2</td>
<td>410 1/2</td>
<td>415-416</td>
<td>+ 1 1/8-2 1/8</td>
</tr>
<tr>
<td>May</td>
<td>413</td>
<td>416 1/2</td>
<td>413</td>
<td>416 1/2</td>
<td>+ 2</td>
</tr>
</tbody>
</table>
Hedging Arithmetic

The arithmetic of a hedge is illustrated by the following examples. Suppose that on December 1 a grain elevator operator has in storage 5,000 bushels of soybeans valued at $3.60 per bushel. To protect against a price decline he sells a May futures contract for $3.80 per bushel. In February he will simultaneously sell soybeans and buy a May futures contract. Assume that by February when he sells the cash soybeans and buys the futures contract both cash and futures prices have declined 10 cents per bushel. In this example the elevator operator lost 10 cents per bushel when he sold the cash soybeans and gained 10 cents per bushel when he bought back the futures contract. The loss on the cash price was exactly offset by the gain on the futures price. It should be pointed out that while the hedge protects against a loss it also precludes a gain from a price increase. As an illustration assume that in the previous example the price of soybeans had risen. In this example had he not hedged, the elevator operator would have gained an extra 10 cents per bushel.

In these two examples, the hedge worked perfectly, that is, in the first example the loss in the cash market was exactly offset by the gain in the futures market, and in the second example the gain in the cash market was exactly offset by the loss in the futures market. This situation rarely occurs in practice, however. While cash and futures prices usually vary together in response to fluctuating market conditions, they generally do not move in lock step fashion.

The difference between the futures price on any exchange and the local cash price is called the basis. Basis varies among geographic locations and changes from month to month in each location, normally narrowing as the delivery month approaches. The basis reflects primarily the cost of transportation and storage. At any specific time, for example, the basis in a local area will approximately equal the cost of delivering the grain to the city in which the exchange is located plus the cost of storing it until the delivery month. The basis is normally highest at harvesttime since cash prices are depressed relative to futures. Because the basis reflects storage costs, it usually narrows as the month of delivery approaches.

In the case of grains cash prices at most locations around the country are usually below the Chicago futures price. The exact amount of this difference—the basis—varies from location to location and from month to month. For example, if soybeans in Richmond, Virginia, during November typically sell for 18 cents per bushel below the July futures in Chicago, the basis for November is 18 cents. In April the basis might be 6 cents. Even though basis varies from month to month, it usually follows a fairly consistent and distinct pattern. That is, the basis in April of one year is likely to be about the same as it was in April of other years.

The Storage Hedge

Because the basis normally narrows from harvesttime to the delivery month of the contract, an elevator operator can store grain and earn a profit on it and protect himself against price level changes by hedging. Assume that at the time of harvest in October a local elevator operator purchases 5,000 bushels of soybeans for $4.30 per bushel. He could immediately resell the soybeans at a price high enough to cover handling costs, including a profit. But this would leave him with idle storage space on which he would like to earn a return. Given the price he paid for the soybeans and the cost of insurance, taxes, and depreciation, he calculates that he will need to sell in May at a net local price of $4.40 per bushel. He thus establishes $4.40 as his price objective.

The difference between the futures price on any exchange and the local cash price is called the basis. Basis varies among geographic locations and changes from month to month in each location, normally narrowing as the delivery month approaches. The basis reflects primarily the cost of transportation and storage. At any specific time, for example, the basis in a local area will approximately equal the cost of delivering the grain to the city in which the exchange is located plus the cost of storing it until the delivery month. The basis is normally highest at harvesttime since cash prices are depressed relative to futures. Because the basis reflects storage costs, it usually narrows as the month of delivery approaches.

In the case of grains cash prices at most locations around the country are usually below the Chicago futures price. The exact amount of this difference—the basis—varies from location to location and from month to month. For example, if soybeans in Richmond, Virginia, during November typically sell for 18 cents per bushel below the July futures in Chicago, the basis for November is 18 cents. In April the basis might be 6 cents. Even though basis varies from month to month, it usually follows a fairly consistent and distinct pattern. That is, the basis in April of one year is likely to be about the same as it was in April of other years.
From the historic records of basis he determines that the local price of soybeans is typically 18 cents per bushel below the July futures at harvest and that this basis usually narrows to 8 cents in May. While this basis pattern is not certain, it is considerably more certain than what the actual price of soybeans will be in May.

Checking prices he finds that the usual 18 cents harvesttime differential does in fact exist and that the July futures is selling at $4.48 per bushel. If basis follows the normal pattern and narrows to 8 cents in May the futures price of $4.48 should result in a net local price of $4.40 in May. His price objective met, he hedges by selling one contract (5,000 bu.) of July soybeans. Assume that between October and May the local price of soybeans drops from $4.30 to $4.20. An unhedged storage of soybeans would have resulted in a loss of 10 cents per bushel plus the cost of storage. If in actuality the May basis is 8 cents, the Chicago July futures price is $4.28.

Selling his soybeans for the local price of $4.20 results in a loss of 10 cents per bushel in the cash market. Offsetting his futures market position by buying a July futures contract for $4.28 per bushel results in a profit of 20 cents per bushel. The following is a summary of his transactions.

<table>
<thead>
<tr>
<th>CASH MARKET</th>
<th>FUTURES MARKET</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>October</strong></td>
<td><strong>October</strong></td>
</tr>
<tr>
<td>Buys 5,000 bu. @$4.30</td>
<td>Sells 5,000 bu. @$4.48</td>
</tr>
<tr>
<td>May</td>
<td></td>
</tr>
<tr>
<td>Sells 5,000 bu. @$4.20</td>
<td>Buys 5,000 bu. @$4.28</td>
</tr>
<tr>
<td>Loss 10¢ per bu.</td>
<td>Profit 20¢ per bu.</td>
</tr>
</tbody>
</table>

The May cash price of $4.20 per bushel plus the 20 cents per bushel profit on the hedge results in a net price of $4.40—his price objective. Hedging allowed him to establish a storage return and simultaneously protect himself against a price decline.

In this hypothetical example the basis movement was exactly as expected—from 18 cents in October to 8 cents in May. The hedger will seldom be able to predict exact movements in basis, however. In actuality, when a hedging position is to be closed by an offsetting futures transaction, there is a risk that the relationship between cash price and futures price may be different than expected. This uncertainty is referred to as basis risk, and its existence makes hedging an imperfect method of price protection. For instance, in the example, if the basis had narrowed to only 10 cents by May, the hedger would have realized an 18 cents rather than a 20 cents profit per bushel. Thus, the cash price of $4.20 plus the futures profit of 18 cents per bushel would have resulted in a net price of $4.38—2 cents short of his price objective at the time he hedged. Although there is some risk in estimating the basis, it is less risky than estimating changes in the price level.

**Establishing a Price in Advance** A farmer may establish the price of a growing crop by using the futures market. For example, assume that in July the futures price for November soybeans is $4.25 per bushel. Knowing that the typical November basis in his area is around 16 cents, the farmer realizes that the futures price of $4.25 translates into a local price of $4.09. He decides that he would be satisfied to sell his anticipated production of 5,000 bushels at this price. Accordingly, he sells soybeans for November delivery.

In November, when he is ready to deliver his soybeans, he finds that the local price of soybeans is $3.89. As anticipated the basis is 16 cents—meaning that the Chicago futures price is $4.05. He sells his beans locally and simultaneously buys back his futures contract. The cash price of $3.89, plus the 20 cents per bushel profit on the futures transaction, yields a total price of $4.09 for his bean crop.

The foregoing example illustrates how a farmer can use the futures market to establish a price for his growing crop. Farmers can also use the futures market: (a) to earn a payment for holding a crop in storage, (b) to establish the cost of feed to be purchased at a future date, and (c) to speculate on a price increase without storing the crop.

**Forward Contracting** Many crops are produced under cash contract. That is, at some time prior to the actual delivery of the commodity a producer enters a contract with a local processor or marketing firm to deliver the commodity at a specified time for a specified price. Contrary to the futures market, in which most contracts are cancelled, in contracting, delivery and acceptance of the actual commodity are expected. For example, a farmer can sell corn in

---

8 Actually a farmer would probably not hedge all of his anticipated production. The amount hedged will depend on a number of factors such as the amount of risk he is willing to accept and his speculative skills.
October for delivery in January or March. A knowledge of the futures market and the concept of basis can be valuable to a farmer who intends to sell his crop under forward contract. By checking the futures price for the month in which he plans to deliver his commodity to the forward buyer, and subtracting typical basis for that month, he can tell if he is being offered a reasonable price for his commodity.

Although the specific examples given in this article relate to grain producers and handlers, other businessmen also use the futures markets. Livestock feeders can hedge and lock in an acceptable selling price in advance. Similarly, processors can establish in advance the selling price of finished products or the buying price of raw materials.

**Hedging and Credit** In addition to enabling a businessman to protect himself against price changes, hedging frequently facilitates credit acquisition. In the case of grains, lenders generally will advance credit more readily and in larger amounts against a hedged inventory than against one not hedged. Ordinary bank financing is readily available for the purchase and storage of hedged inventories, and lenders will frequently lend up to 90 percent of the value of a hedged commodity as opposed to 60 to 70 percent of an unhedged one. In a loan against a hedged commodity the warehouse receipts serve as the collateral. It is not hard to understand why lenders will lend more against a hedged commodity since a commodity protected against erratic and sometimes rapid price changes provides a relatively safer collateral.

The growing complexity of the business environment along with the increased size of agribusiness firms has increased the reliance on outside capital, mostly in the form of debt. Consequently, the stability of returns from commodities has become increasingly important to the borrower and the lender. Because of these factors, transactions in the futures markets are likely to assume a growing importance in the daily operations of many business enterprises.

**Conclusions** A futures market provides a mechanism whereby traders can establish now the price of products they intend to buy or sell in the future and where speculators can attempt to profit from commodity price fluctuations. In addition to providing a method of protection against price level changes, hedging makes credit more accessible. Banks generally will lend more willingly and in relatively larger amounts to a producer or owner who hedges. While the mechanics and the arithmetic of a hedge are fairly easy to understand, successful hedging is not a simple matter. Detailed study of the markets and a broad knowledge of commodities, transportation costs, and general economic conditions are necessary to be a successful hedger. This article was designed to explain only the basic principles of the futures market and hedging. For the reader wanting more detail, several references are listed.

*Thomas E. Snider*

**REFERENCES**


RECENT CHANGES IN FIFTH DISTRICT SMSA's

According to the most recent listing of the Standard Metropolitan Statistical Areas released in April 1973 by the Office of Management and Budget, there are now 267 SMSA's in the United States and Puerto Rico. Twenty-three of these are located wholly or partially in the Fifth District. Two areas, Burlington, North Carolina and Kingsport-Bristol, Tennessee-Virginia, have been designated as new Standard Metropolitan Statistical Areas in the Fifth District since the last revision in November 1972. Three new areas were formed by combining existing areas—Charlotte-Gastonia, North Carolina; Raleigh-Durham, North Carolina; and Greenville-Spartanburg, South Carolina. These combinations resulted from a growing social and economic integration of those areas. Thirteen areas were redefined, and five areas remained the same.

The concept of the Standard Metropolitan Statistical Area was devised to present statistical data on a standard geographical basis for purposes of economic analysis. In 1949, the standard definitions were first issued as “Standard Metropolitan Areas” to replace four different sets of definitions then in use for various Federal statistical series. They were “metropolitan districts,” “metropolitan counties,” “industrial areas,” and “labor market areas.” Each of these series contained a slightly different territory, making it impossible to relate the statistics on population, housing, industry, trade, employment, and other areas of economic analysis to a particular geographic area. By using standard definitions, comparable statistics could be generated by Federal agencies as well as by state and local governments and private statistical agencies. The term “standard metropolitan area” was changed to “standard metropolitan statistical area” in 1959 in order to describe more accurately the objective for defining the areas. They are defined and their titles established by the Office of Management and Budget with the advice of the Federal Committee on Standard Metropolitan Sta-

APRIL 1973 SMSA’S: DEFINITIONS AND BOUNDARY CHANGES SINCE 1950

1. BALTIMORE, MD. Baltimore City; Counties: Anne Arundel, Baltimore, Carroll (added June 1959), Harford (added March 1967), Howard (added June 1959).


4. LYNCHBURG, VA. (New area, May 1959). Lynchburg City; Counties: Amherst, Appomattox (added April 1973), Campbell.


8. RICHMOND, VA. Richmond City; Counties: Charles City (added April 1973), Chesterfield, Goochland (added April 1973), Hanover (added October 1963), Henrico, Powhatan (added April 1973).


---

a Became an independent city and separated from Fairfax County, October 1968.
c Title changed from Norfolk-Portsmouth Va. to Norfolk-Virginia Beach-Portsmouth, Va., November 1971 and to the above listing, April 1973.
d Created by consolidation of South Norfolk City and Norfolk County, October 1963.
e Became an independent city and separated from Princess Anne County, January 1952. Princess Anne County consolidated with Virginia Beach City, October 1963.
f Title changed November 1971 from Petersburg-Colonial Heights, Va.
g Became an independent city and separated from Roanoke County, March 1968.
h Formerly Charlotte and Gastonia areas. Combined and title changed, April 1973. Gastonia was designated a new area, November 1971. Union County added to Charlotte area, October 1963.
i Formerly Winston-Salem and Greensboro-High Point areas. Combined, title changed, and Randolph and Yadkin Counties added, March 1967.
k Formerly Greenville and Spartanburg areas. Combined and title changed, April 1973. Spartanburg was designated a new area, November 1971. Pickens County added to Greenville area, October 1963.
itical Areas, which is composed of representatives of the major statistical agencies of the Federal Government.

An SMSA always includes at least one central city and its surrounding county or counties. The area may cross state boundaries if the economic and social relationships between the central and contiguous counties meet specified criteria of metropolitan character and integration.

The majority of Standard Metropolitan Statistical Areas consist of one city with a population of 50,000 or more. A contiguous county is included in the area if at least 75 percent of the resident labor force of the county is engaged in nonagricultural pursuits and at least 30 percent of the employed workers living in the county work in the central county or counties of the area. The urban character of a county is determined by the fulfillment of two of the following criteria: (1) at least 25 percent of the population is urban, (2) the county had an increase of at least 15 percent in total population during the period covered by the two most recent Censuses of Population, and (3) the county has a population density of at least 50 persons per square mile. One of the basic criteria for measuring economic integration is the relationship of place of residence to place of work.

The present definition of each SMSA in the Fifth Federal Reserve District and the boundary changes made since 1950 in each area are given in the accompanying table. The numbering system on the definitional table is used on the map showing the present boundaries. Population data shown on this map were derived from the 1970 Census of Population.

Patricia G. Rhodes

The service sector of the economy has exhibited impressive growth over the past decade. In 1972, services accounted for almost 42 percent of Gross National Product, compared with 37 percent in 1960. Employment in the service sector—which encompasses such areas as cleaning, food, health, personal, and protective services—increased by over 36 percent between 1960 and 1972. Growth among the several component activities of this important sector of the economy was by no means uniform, however. In particular, the subsector denoted as private household services declined sharply between 1960 and 1972, with the number of persons employed in this area decreasing by over 27 percent.

In 1972, approximately 1.5 million people were employed in private household services in such capacities as maids, butlers, babysitters, and chauffeurs, while over 80 million individuals were employed in all occupational groups. Almost half of all household workers were employed in the South, and the highest ratio of household workers to population was also found in the southern states. In 1970, the national average ratio of household workers to population was 5.5 to one thousand. Most areas in the Fifth District, with the exception of Maryland and West Virginia, had substantially higher-than-average ratios. The District's share of total household workers has increased slightly over time. In 1920, about 11 percent of all household workers were employed in the Fifth District; in 1970, about 14 percent. The most dramatic historical changes, however, have been on a national rather than a regional level.

---

**Chart 1**

RELATIVE EARNINGS OF PRIVATE HOUSEHOLD WORKERS

1951-1970*

- Average reported wages of private household workers as a percentage of average reported wages of all wage and salary workers.

The household service sector is a relatively small one in the United States economy today, and its recent decline suggests several important underlying social and economic changes.

Supply: Characteristics of Household Workers

Women have increasingly predominated in household work. In 1972, women constituted over 98 percent of the total, as compared with approximately 80 percent in 1920. Negroses accounted for slightly over half of all household workers in 1970. The average household worker is older than other workers. In 1960, the median age of household workers was 46, compared with 40 years for all workers. In 1965, the median age had increased to 52 years versus 37 years for all workers. The progressive increase in the average age of household workers seems to be part of the trend toward a diminishing pool of domestic employees. As fewer younger people enter domestic service, the remaining older workers raise the average age. Lack of extended education is another key characteristic of household employees. In 1972, the median years of school completed by household workers was 9.9, two and a half years less than the average for all occupational groups.

Younger, more highly educated individuals appear, therefore, to be shifting from the household service sector into other fields. One reason for this movement, perhaps, is the low level of household wages. Because of incomplete reporting, there may be inaccuracy in the estimation of household earnings, but an evaluation of the record over time provides some indication of the relative differentials between the earnings of household workers and those of other workers in the economy. In 1951, for example, average earnings per household worker were about 37 percent of those for all wage and salary workers; in 1970, this ratio had declined to about 22 percent. As approximately 65 percent of these workers were part-time (less than 35 hours), it is helpful to consider the wages of a full-time household employee. In 1969, the median wage of a full-time female household worker was $1,851—45.75 percent, or less than half, of that of the average female wage and salary worker.

Effective minimum wage coverage is available to household workers in only a few states, among them Massachusetts, New York, and Wisconsin.

---


2 Although several states have minimum wage laws applicable to domestic workers, coverage is limited because of certain exemptions applying to the number of persons employed in a household. See Women's Bureau, U. S. Department of Labor, Employment Standards Administration, "Women Private Household Workers Fact Sheet" (1971), release revised 1972.
Furthermore, few states have effective legislation governing overtime compensation, workmen's compensation, or unemployment compensation for household workers. Consequently, the private domestic worker is not furnished with the benefits and protection that the majority of workers receive.

The Demand for Household Workers

One of the most salient trends discernible in recent employment statistics has been the increase in the participation rates of married women in the labor force. In the postwar period, the percentage of married women active in the labor force has more than doubled, from 20.0 percent in 1947 to 41.5 percent in 1972. A parallel trend has been the growing importance in American society of the so-called "nuclear" family, i.e., a family consisting only of parents and their children. Few families today include a grandparent or other older relative. In 1971, only one out of 15 households with a working mother with dependent children included a nonemployed adult woman (such as a grandmother), and only one out of 25 households with dependent children under age six included an additional nonemployed woman. The combination of an increase in the percentage of married women who are working and an increased relative importance of the nuclear family would seem to make for an enlarged demand for household help.

Several other considerations, however, exert countervailing influences. The postwar decline in birth rates, from 25.8 per 1,000 population in 1947 to 17.3 per 1,000 population in 1971, coupled with dramatic increases in the use of labor-saving appliances, convenience foods, and easy-care fabrics, probably has lessened the need for domestic services. Also, changing attitudes toward housework among men has led to what is probably a more efficient inter-family sharing of household chores, with a consequent reduction in the demand for outside help.

It is difficult, consequently, to predict the nature of the demand for household services. Regardless of the improvements in labor-saving devices, there would still seem to be some need in the future for specific cleaning services, particularly those of a heavy-duty nature. Perhaps such services will be provided by contractual cleaning services. Wages in these services, unlike those for private domestics, have been increasing in past years. Furthermore, in most areas, the majority of the workers employed by these establishments receive paid vacations and holidays and some kind of health, pension, or insurance plan. Such contractual services offer benefits not only to the employee but also to the employer, who may not wish to retain an employee on a regular basis. Contractual services may, in fact, be the only viable area in domestic services, which would make the private household worker increasingly rare.

Susan P. Krug

The Monthly Review is produced by the Research Department of the Federal Reserve Bank of Richmond. Subscriptions are available to the public without charge. Address inquiries to Bank and Public Relations, Federal Reserve Bank of Richmond, P. O. Box 27622, Richmond, Virginia 23261. Articles may be reproduced if source is given. Please provide the Bank's Research Department with a copy of any publication in which an article is used.