



REGIONAL ECONOMIST | JULY 1994

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President's Message: A Low Inflation Policy Is a Pro-Growth Policy

Thomas C. Melzer

Over the years, the Federal Reserve has often been accused of paying too much attention to inflation. Indeed, we're hearing that charge today, as critics worry about a continuation of Federal Reserve moves last spring to pursue a less accommodative monetary policy. In its zeal to keep inflation low, critics say, the Fed is stifling economic growth.

Unfortunately, what such criticism implies is that, when the Fed pays attention to inflation, it disregards economic growth. In fact, quite the opposite is true.

Many developed countries have attempted to run higher inflation policies in the name of economic growth since World War II. They do this by consistently keeping short-term interest rates low, which fosters relatively high monetary growth rates over time. The evidence shows, however, that these economies grow no faster than countries that pursue relatively low inflation policies.

The same holds true for developing countries. A recent study at MIT, which considers the effects of inflation policy on economic growth in Latin America, Asia and Africa, looked at countries from across these continents and found that those with relatively high average inflation rates tended to grow more slowly than those closer to price stability, even after taking account of other factors that can influence the economy.

When it comes down to it, fostering inflation in the hope of more rapid economic growth is like chasing a mirage through the desert. You can travel a long distance, under harsh conditions, and end up with no water. Similarly, we can endure higher inflation rates for a long period of time and end up with no additional economic growth.

A low inflation policy, of course, is not an end in itself. The Fed seeks a stable, low inflation environment for a very pragmatic reason: relatively steady prices contribute to better economic decision-making.

In my opinion, the main contribution the Fed can make to the economy in the long run is to keep inflation low and inflation uncertainty to a minimum. This means maintaining a consistent policy over a long period of time with a credible commitment to low inflation. In this way, monetary policy can provide a stable price backdrop that will enable the nation to achieve the maximum sustainable rate of economic growth. That is a pro-growth policy, and one that I think the Federal Reserve should continue to pursue.



Commodity Price Indexes: Can They Predict Inflation?

Kevin L. Kliesen

Is inflation poised to move higher, perhaps to the double-digit levels last seen from 1979 to 1981? The answer to this question is currently one of the most intensely debated issues among economists and policymakers. Those who believe that inflation is well-contained point to the trend growth rates of the consumer price index (CPI) and the producer price index (PPI), which are currently less than 3 percent and 1 percent, respectively—the best performance for both since oil prices declined dramatically in 1986.¹ Those who see inflation rates going inexorably higher point to the dramatic increase in the yields on inflation-sensitive, 30-year Treasury bonds, which have risen more than 150 basis points between October 1993 and late June of this year. Another potentially useful piece of evidence to ponder, however, is the behavior of commodity prices. What—if anything—can they tell us about future inflation rates?

The Importance of Commodity Prices

In a market economy, resources like labor and machinery (capital) are distributed on the basis of supply and demand. In such a system, prices serve as the mechanism by which resources are allocated to their most productive uses. For instance, suppose a reduction in the supply of crude oil creates a gasoline shortage, causing gasoline prices to rise. Those firms or individuals that are more sensitive to price changes will decide to use less gasoline, while those who are less sensitive to changes in gasoline prices will purchase about the same amount as they did before. In this manner, the change in price ensures that the reduced quantity of gasoline will go to those users who value it the most.

Is a (one-time) rise in the price of gasoline a precursor to inflation? Although an important input into the production of many goods and services, gasoline is but one good in an economy made up of tens of thousands of goods and services. At any one time, the prices of some goods and services will be rising, while the prices of others are declining. A one-time increase in the price of gasoline, or any other commodity, does not constitute inflation. Inflation occurs, instead, when there are *persistent* increases in the prices of many goods and services.² As inflation rises, so typically does uncertainty about future inflation; this uncertainty then disrupts the functioning of the price mechanism, leading to inefficiencies in resource allocation.³

The "Pass-Through" Process

Future inflation is often hard to detect in the present for several reasons. First, the effects of excessive money growth, an important determinant of future inflation, typically are not felt for several quarters—perhaps years. Second, because many wages and prices are fixed by contracts between buyers and sellers, it takes some time before any price increases are passed along. This latter reason leads some economists to consider commodity prices an indicator of future inflation.

The principal linkage between changes in commodity prices and the inflation rate is rather straightforward. For instance, rubber is an important component in the production of tires. All other things equal, a rise in rubber prices will eventually result in higher tire prices, which in turn may be passed on in the form of higher car and truck prices.⁴ Perhaps much of the recent alarm in financial markets stems from the double-digit increases in many commodity prices since last year. Substantial increases have occurred in the prices of lumber, steel, oil, cotton and cocoa, as well as many others. Eventually, to some degree, this portends higher prices for houses, autos, gasoline, clothes or candy bars. When viewed through this lens, indications are that higher prices are around the corner—although how much higher, no one knows.

Weighing the Evidence

The table lists the percentage change over various periods for four popular commodity price indexes and the CPI measure of overall inflation. Two distinguishing characteristics are important to note among the various commodity price indexes. First, except for the Journal of Commerce index (JOC), each is measured on a futures price basis; the JOC index measures commodity prices on a "spot"—or cash—basis, the price that prevails at the current time. A futures price is the price that prevails on a futures contract, which stipulates the date, location, quantity and quality of a commodity the owner of the contract is legally bound to deliver.⁵ Although changes in spot prices are useful in determining current inflationary pressures, changes in futures prices provide a barometer of future price movements, hence, the name.⁶

Table 1

Change in Selected Commodity Price Indexes Over Various Periods

Monthly Data (May 1994)

Price Index	Sector Weighted Heaviest (percent)	Simple Percent Change Over the Most Recent Period Indicated							
		3 mo.	6 mo.	12 mo.	18 mo.	24 mo.	36 mo.	48 mo.	60 mo.
CRB Futures	Agricultural (48%)	1.1	4.6	9.9	14.0	10.6	6.5	-6.4	-2.9
Dow Jones Futures	See note	-1.2	7.0	17.5	22.0	21.1	13.3	7.4	6.2
Goldman Sachs	Energy (48%)	3.2	7.1	-2.5	-1.9	-8.4	-8.4	-6.9	-6.2
Journal of Commerce	Industrial metals (35%)	4.6	7.2	4.9	4.5	3.0	2.8	-3.1	-4.0
CPI	Housing (41%)	0.7	1.2	2.4	3.9	5.7	8.8	14.3	19.3

NOTE: The Dow Jones Futures index includes 12 commodities of equal weight: 6 agriculture, 3 industrial, 2 livestock and gold.

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A second characteristic is the type and importance of commodities included in the index. Depending on the index, changes in a particular commodity price will have a larger effect on some indexes than on others. For example, the price of burlap, although no doubt important in certain industries, is not as important a commodity as, say, crude oil. Therefore, one would expect that a 10 percent increase in crude oil prices would have a larger effect on the Goldman Sachs commodity index (GS), which attaches a significant weight to the energy sector (48 percent), than it would on the Dow Jones futures index (DJ), which does not include crude oil prices at all. Thus, when tracking commodity price movements through a particular index, one must be aware of what is driving the index.

As the table shows, the various commodity price indexes often move in significantly different directions over various periods. What's more, they sometimes move in the opposite direction of the CPI. Over the past six months, for example, consumer prices have increased 1.2 percent; meanwhile, commodity prices, by any measure, have increased substantially more, ranging from a 4.6 percent rise in the Commodity Research Bureau's (CRB) futures index, to a 7.2 percent rise for the JOC index.

Although this discrepancy widens over time, commodity price indexes and consumer inflation generally have moved in the same direction over the last three years (36 months). Over a longer horizon, however, the linkage appears to be less precise: consumer prices have increased 19.3 percent over the past five years (60 months), while most commodity price indexes have *decreased*, reflecting the negative long-term trend of commodity prices relative to those of all other prices. This pattern may not hold all of the time because each index weights individual commodities differently, and most commodity prices do not rise and fall in lockstep on a continuous basis. For example, reflecting the weakness in oil prices over the last few years, the GS index—heavily weighted toward energy prices—shows commodity price *deflation* over the past 12 months to 60 months. The DJ index, by contrast, shows just the opposite.

This discrepancy also arises because a significant part of the CPI measures inflation in the service sector, which, by and large, is little influenced by changes in commodity prices. Despite these shortcomings, one should not downplay the usefulness of commodity price indexes. They still offer additional information about price pressures in the economy that may be hard to detect in the broader measures of price changes. Nevertheless, the analyst who follows commodity price indexes would be well advised to look at a cross section of indexes, not just focus on one.

Heidi L. Beyer provided research assistance.

Endnotes

1. The trend inflation rate is defined as the percentage increase in each index on a continuous 12-month moving average basis. [back to text]
2. A discussion of the causes of inflation is outside the scope of this article. For an introductory discussion of this topic, see Keith M. Carlson, "Do Price Indexes Tell Us About Inflation? A Review of the Issues," *Review*, Federal Reserve Bank of St. Louis (November/December 1989), pp. 12-30. [back to text]
3. In general, the costs of inflation depend on the extent to which it is anticipated or not. For some insights into the costs of inflation, see Michelle R. Garfinkel, "What Is an "Acceptable" Rate of Inflation?—A Review of the Issues," *Review*, Federal Reserve Bank of St. Louis (July/August 1989), pp. 3-15. [back to text]
4. Some situations may arise to prevent such a "pass through." Increases in rubber prices may be absorbed by the tire manufacturer if competitive pressures precluded such a move; in such a case, the firm would incur increased costs and reduce profits, perhaps leading to decreases in employment. The firm may also offset the higher prices through increased productivity. In this instance, the firm would reduce its costs by making its workers and machines work more efficiently, producing more output with fewer (or the same) amounts of inputs. [back to text]

5. For example, a holder of a crude oil futures contract is legally required to deliver to a specific place 1,000 barrels of crude oil at the time of the contract's expiration. [back to text]
6. Despite these differences, spot and futures prices for most commodities tend to move together closely over time. Furthermore, because of arbitrage, spot and futures prices converge by the date of the contract's expiration. [back to text]

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Going Interstate: A New Dawn For U.S. Banking

Michelle Clark Neely

The day interstate branching proponents have hoped for—and opponents have dreaded—is about to dawn. After years of debate, Congress appears to be ready to pass legislation that paves the way for nationwide interstate branching in the United States beginning in 1997.

This legislation could have far-reaching effects for the banking industry, as well as for U.S. consumers and businesses that depend on banks for their credit and depository needs. The removal of geographic restrictions on how and where a bank can operate is sure to change the structure of the U.S. banking industry—the number of banks, their size and the type of products they offer.

Roadblocks at the Border

The banking industry is one of the most heavily regulated industries in the United States and is arguably the most heavily regulated banking system in the world. Because the United States has a dual banking system—banks can be chartered and supervised by the states or the federal government—many banks are subject to a vast number of state and federal regulations. There are regulations related to safety and soundness, such as minimum capital requirements; consumer protection, such as the Truth in Lending Act; credit availability, such as the Community Reinvestment Act (CRA); and geographic restrictions on bank operations, such as limits on branching. Many regulations are aimed at protecting the federal deposit insurance fund.

Geographic restrictions on banking (establishing bank subsidiaries) and branching (establishing bank branches) have ebbed and flowed since the Civil War. In this century, most changes have occurred at the state rather than the federal level.¹ While concerns about dismantling geographic restrictions on banking are many, the two major fears are that economic power will become too concentrated and local economies will be harmed if local banks are not protected from competition.

Throughout most of the 20th century, local banks in the United States have been protected from both interstate and intrastate competition. Since the late 1920s, state legislatures have held most of the cards, in effect determining whether a bank could establish subsidiaries and branches, even if it had a national charter. That's because current federal laws governing expansion powers for state and national banks have a "states' rights" bent to them, generally allowing states to preempt federal laws by passing more or less restrictive legislation.²

Two major pieces of federal legislation currently govern interstate banking and branching: the Bank Holding Company Act of 1956 and the McFadden Act of 1927 (amended 1933). The Bank Holding Company Act, or more specifically the Douglas Amendment to the Act, prohibits a bank holding company (BHC) from acquiring an out-of-state bank subsidiary unless the home state of the acquired bank has a statute authorizing such an acquisition.³ Except for a few grandfathered institutions, multistate multibank BHCs, that is BHCs that operate bank subsidiaries in more than one state, were virtually nonexistent until the late 1970s and early 1980s when a number of states, starting with Maine, passed legislation permitting out-of-state acquisitions. Many states opened their borders simply to attract more capital for economic development.

Every state but Hawaii has since adopted some form of interstate banking. Most feature regional or national reciprocity: Out-of-state acquisitions of home state banks are permitted only if home state banks are permitted to acquire banks in the other state. *De novo* entry—entry through the establishment of a new bank—is generally prohibited; many states permit acquisition only if a bank has already been operating for some fixed period of time, typically three to eight years. In addition, many states place caps on the portion of a state's deposits that can be controlled by an out-of-state organization.

Restrictions on branching have followed a much more convoluted path.⁴ Most of the activity regarding branching restrictions occurred before the 1920s. The McFadden Act and its subsequent amendments essentially prevented interstate branching, permitting national banks to branch only to the same extent as state banks, thus giving the states ultimate authority. As with interstate banking laws, state laws on branching generally did not change between the McFadden Act and the 1980s. Since then, many states have relaxed branching laws, for much the same reasons they relaxed interstate banking laws. Today, all states allow at least limited branching within the state, and most states permit statewide branching. The vast majority of states (42), however, still do not permit interstate branching. The pending legislation will change all that, allowing interstate branching unless a state expressly passes a law prohibiting out-of-state branches—that is, unless the state opts out (see below).

These laws have had profound effects on the structure of the U.S. banking system. Between 1976 and 1992, the proportion of banks affiliated with holding companies increased from 26 percent to 73 percent. While 42 percent of all banks are now affiliated with one-bank (one-state) BHCs, about 31 percent of all banks are now part of multibank BHCs (MBHCs), many of which cross state borders.

In seven states, out-of-state organizations account for more than 60 percent of banking assets; in other states, out-of-state organizations are virtually nonexistent. Although the number of U.S. banks declined throughout the 1980s, the number of branches increased, as a result of relaxed branching restrictions. Table 1, which gives a snapshot of Eighth District states, is a good illustration of the wide variety of banking and branching laws currently in effect and the corresponding differences in banking structure that result.

Bypassing Barriers: The Benefits for Consumers...

After all this time, why is the gridlock on interstate banking and branching legislation finally breaking up? Because its perceived benefits—to consumers, businesses and the banking industry—now outweigh its perceived costs. In addition, policymakers have recognized that the financial services market is now more competitive than it was 20 years ago, giving consumers and businesses a wider variety of options. Moreover, awareness has grown that banks are at a competitive disadvantage in many markets and product areas because nonbank competitors are not subject to the same regulations and restrictions. In other words, Congress is about to act, if only cautiously, on the banking industry's frequent cry to level the playing field.

Finally, as with most industries that are artificially restrained, the banking industry figured out a way to get around the restrictions: As states passed interstate banking laws, out-of-state organizations entered a state via the holding company route, setting up a bank subsidiary which could then, depending on state law, branch statewide or into adjacent counties or cities. Thus, *de facto* interstate branching has already occurred, though not, as many have argued, in an efficient way.

Consumers and small businesses are expected to benefit from the new legislation in several ways.⁵ One set of benefits is generally lumped under the title of "increased convenience." Eliminating barriers to interstate branching will be especially helpful to the 53.4 million Americans who live or operate small businesses in the 37 metropolitan areas that cross state borders.⁶

We can use the District's largest bank—Boatmen's—to illustrate. Under current legislation, a Boatmen's bank customer who lives in Illinois, across the river from St. Louis, but works on the Missouri side of the metro area cannot go to any branch of Boatmen's to conduct his banking business, even though Boatmen's operates in both states. Boatmen's branches on the Missouri side of St. Louis are affiliated with the Boatmen's National Bank of St. Louis; branches on the Illinois side are affiliated with the Boatmen's National Bank of Belleville. Although both are owned by the same bank holding company, Boatmen's Bancshares, they operate as independent companies. An account holder at the Illinois bank can cash a check at a Boatmen's branch in Missouri, but cannot make a deposit.

Under interstate branching, Boatmen's will be able to consolidate its subsidiaries in Missouri and Illinois and make each branch office a part of the same organization. Memphis (Tennessee-Arkansas-Mississippi), Evansville (Indiana-Kentucky), Ft. Smith (Arkansas-Oklahoma), Louisville (Kentucky-Indiana) and Texarkana (Arkansas-Texas) are the other Eighth District metro areas in the same boat.

Cross-state metropolitan areas are not the only likely beneficiaries. People who move frequently, like military personnel, or travel frequently, whether for business or pleasure, could benefit if their banks are able to operate branches across the country.⁷ And business owners who operate in several states may find added convenience as well as reduced costs if they could consolidate their banking accounts with one provider.

Another expected benefit for consumers is an increase in the products available in local markets as large banking companies—those most likely to take advantage of the new law—expand across state lines. Large banks usually offer a wider array of products and services than smaller community banks because they have the volume necessary to make certain products, like credit cards, profitable.

Still another expected benefit is the effect increased local competition will have on the prices of bank products and services. New owners in a market may well lower their prices in an attempt to maintain or increase market share. Prices could also decline if banks pass on to consumers the reduction in costs that many analysts expect to come with interstate banking and branching.

...And for Banks

The banking industry will also benefit from this legislation. As we have seen, banking organizations have been able to get around restrictive state branching practices via the holding company route; unfortunately, it can be a very expensive and inefficient detour. Each subsidiary of a holding company must establish a separate board of directors, file separate regulatory reports, provide audited financial statements, and maintain support functions such as personnel, audit and accounting. Each bank within an organization must meet minimum capital requirements as well as subject itself to regulatory exams and, depending on the chartering situation, multiple examining authorities. Duplicate costs like these are not incurred in a branch system. Some analysts estimate the industry could save millions of dollars annually by eliminating the separate subsidiary requirement. Of course, MBHCs could choose to keep their existing structure under the new law because it confers certain benefits to them that may exceed the costs: One such benefit is a local board of directors that is an excellent referral source for lending opportunities.⁸

A less obvious, but potentially more important, benefit expected to accrue to the banking industry—and to local communities—comes from geographic diversification. By allowing banks to operate in more than one region, the risks associated with a local economic downturn can be reduced. Many of the loan problems suffered by banks in the Southwest in the mid-1980s and in New England in the early 1990s could have been mitigated had these banks had profitable loans in other parts of the country when their regional economies took a nose dive. Local communities could benefit because geographic diversification should make banks financially stronger and better able to withstand loan losses that could deplete capital and curtail lending activities or, in a worst-case scenario, lead to a failure, which would reduce the banking options in a community.

Will the Toll Be Too High?

The greatest fear about interstate banking and branching is the fear of concentration. Some consumer groups and supporters of small community banks believe that a few large banking companies will end up dominating the U.S. banking system. They also argue that these larger, interstate organizations will siphon off deposits from their communities to lend elsewhere, depriving them of economic resources for growth and development.

The evidence does not appear to support these arguments. First, despite the significant declines in interstate banking barriers that occurred in the 1980s through regional compacts and nationwide reciprocal agreements, many measures of industry concentration increased little, if at all. According to the General Accounting Office (GAO), banks with assets of less than \$1 billion—those that opponents fear will be harmed most—were able to maintain their national market share during the 1980s, despite the growth of large banking companies.

Concentration ratios (usually defined as the combined market share of the three dominant organizations in a market) did increase in many markets and in many states during the 1980s, but that does not mean these markets are now less competitive.⁹ Each merger is reviewed by state or federal bank regulators, as well as the Justice Department, for antitrust violations, so even with interstate banking and branching in place, a mechanism still exists to mitigate anti-competitive effects.¹⁰ There's also the evidence from states that have long permitted statewide branching, such as California and North Carolina, to suggest that small community banks can continue to thrive in a less restrictive branching environment.

Holes can also be punched in the argument that large, out-of-state organizations will drain resources from local communities. Banks do not need interstate banking and branching legislation to move deposits out of an area; that possibility already exists through correspondent banking relationships and the fed funds market. Banks with funds they cannot invest at a profit locally can lend these funds to out-of-market or out-of-state institutions through one of these routes or by purchasing loans originated elsewhere. Banks can also purchase investment securities, such as government bonds, if local lending opportunities do not appear profitable.

If markets work efficiently, funds will flow to their most profitable uses; that process should be encouraged, not discouraged. Besides, geographic barriers are not needed to ensure that banks meet their local development responsibilities. The Community Reinvestment Act, which is enforced by bank regulators, directs banks to make funds available to the entire community they serve, including low- and moderate-income neighborhoods. Ultimately, though regulations like CRA may be compelling reasons for banks to reinvest in their communities, the competitive market mechanism provides an even greater stick: Banks that ignore profitable local investment opportunities do so at their peril because competitors would be only too happy to take the business away.

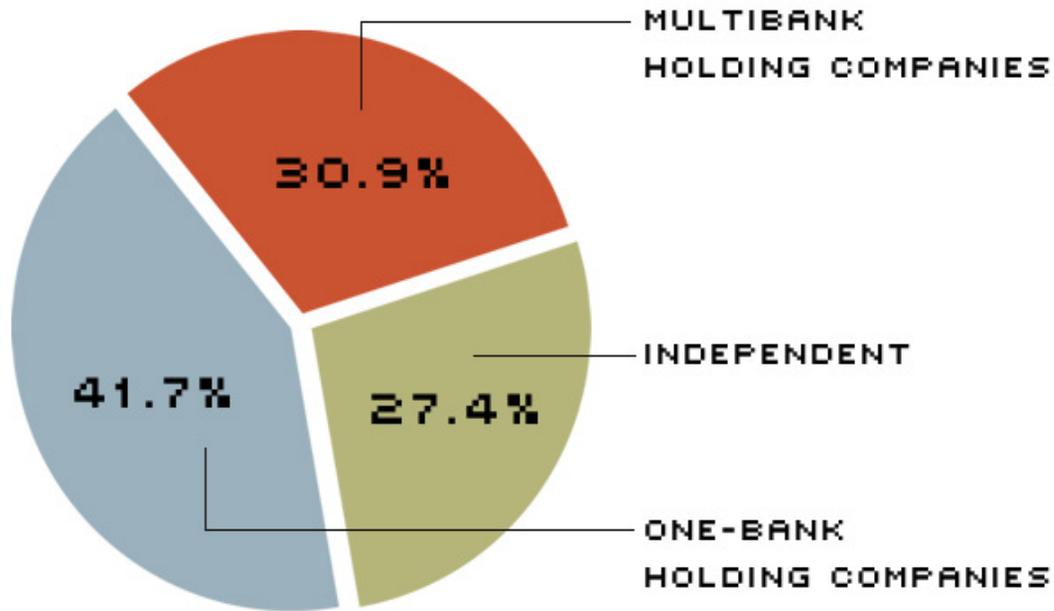
Redrawing the Road Map

What will happen to U.S. banking markets once the legislation passes? No one, of course, knows the answer to that question, but speculation abounds. In markets located in states with already liberalized banking and branching laws, little will change. In states like Arkansas and Missouri—with limited branching and regional reciprocal interstate banking laws on the books—a *lot* could change, assuming the states do not opt out of interstate branching. A mini-industry of predicting which banks are ripe for takeover and which will go on an acquisition spree has already cropped up. Whatever the outcome in individual markets, the banking industry should emerge leaner and meaner from this road trip.

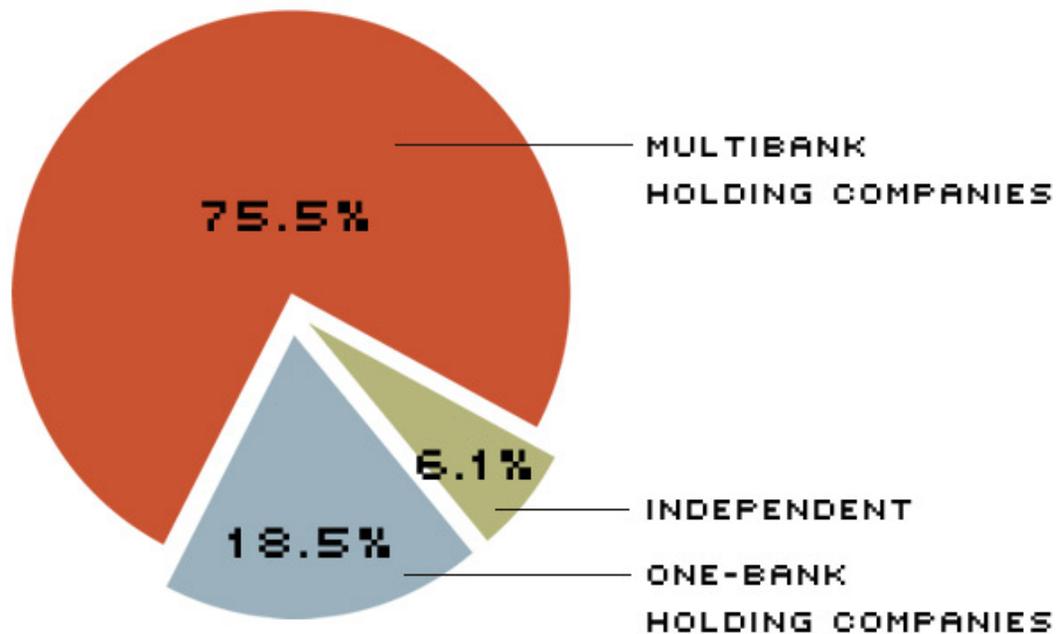
Figure 1

Bank Holding Companies Have Changed the Industry Landscape

NUMBER OF BANKS 11,450



BANK ASSETS \$3,487 BILLION



Though independent banking companies are still highly represented in numbers, comprising about a third of U.S. banks, their share of industry assets is much smaller. Banks associated with one-bank or multibank holding companies hold about 94 percent of the industry's assets.

Data are as of December 1992.

Table 1

Awaiting Interstate Branching: Where District Banks Stand Today

State	Interstate banking law	In-state branching law	Percentage of assets held by out-of-state banking companies
Arkansas	RR	L	2.1%
Illinois	NR	S	21.7
Indiana	NW	S	52.9
Kentucky	NR	L	40.4
Mississippi	RR	S	2.1
Missouri	RR	S	1.9
Tennessee	NR	S	29.3

State	Concentration ratio of the three largest banking companies	Percentage of national banking assets held in state	Number of banking companies	Number of five largest banking companies with headquarters out of state
Arkansas	25.6%	0.7%	190	0
Illinois	37.3	5.8	714	2
Indiana	41.3	1.7	181	4
Kentucky	38.2	1.3	236	3
Mississippi	42.2	0.7	120	0
Missouri	46.7	1.9	362	0
Tennessee	39.6	1.5	203	2

NW = Nationwide banking

NR = Nationwide reciprocal banking

RR= Regional reciprocal banking

S = Statewide branching permitted

L = Limited area branching only

NOTE: Banking/branching status as of July 1994; data are for the period ending December 31, 1992.

SOURCES: Conference of State Bank Supervisors and FFIEC Reports of Condition and Income.

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The Long and Winding Road

The road toward nationwide interstate banking/branching has been a difficult one to navigate, chock full of twists and turns. In previous Congressional sessions, legislation was typically derailed by amendments on controversial issues like bank insurance powers and basic banking services for the poor—issues that made the bill unpalatable to many in Congress and the banking industry. In addition, trade groups representing different constituencies within the banking industry were divided on the issue, with groups representing smaller community banks, such as the Independent Bankers Association of America (IBAA), opposing legislation on the grounds that their members would be swallowed up by larger institutions.

At this writing (July 8, 1994), a Congressional conference committee is hammering out differences in two versions of a nationwide interstate banking/branching bill—one passed by the House in March, the other passed by the Senate in April. Most analysts expect that agreement will be reached soon and a bill will land on President Clinton's desk by Labor Day.

The bills contain similar provisions on most issues. They include:

- *Interstate banking enactment date.* Both bills would permit a bank to acquire another bank in any state one year after the enactment of the legislation.
- *Protection of state entry laws.* Both bills allow states to continue to determine how long an institution must be in existence before it can be acquired.
- *Concentration limits on deposits.* Both bills limit the proportion of a state's bank and thrift deposits that an institution could control through acquisition; the House bill sets the limit at 30 percent and the Senate sets the limit at 25 percent.
- *Opt-out provisions.* Both bills allow states to opt out of interstate branching; the House version gives states three years to opt out while the Senate sets no deadline on the decision.
- *CRA evaluations.* Both bills require banks with interstate branches to undergo a consolidated Community Reinvestment Act (CRA) exam, as well as separate exams for each state, metropolitan area and non-metropolitan area.

Though the two bills do not agree on the dates on which consolidation of subsidiaries into branches and new branch purchases may begin, staff for the House and Senate conferees have already worked out a compromise for approval, setting June 1, 1997, as the starting date for both types of branching.

Despite this broad agreement, sharp differences remain between the House and Senate on two contentious issues. The first is the applicability of state law. The House version of the bill requires national bank branches to be treated as state-chartered banks in certain regulatory areas, notably state consumer protection laws; the Senate version allows the federal government or, more specifically, the Office of the Comptroller of the Currency (OCC), to preempt state law. A compromise currently being discussed would make national bank branches subject to state law in four areas: state community reinvestment, consumer protection, fair lending and intrastate branching laws. Before preempting state law in any of these areas, the OCC would have to subject its rulemaking proposal to public comment. While this issue is not totally resolved, most analysts are confident that an acceptable compromise can be reached.

Observers are less sanguine about the other hotly contested issue—the treatment of foreign banks under interstate branching. The U.S. Treasury Department has entered the fray on this issue, siding with the House, which essentially wants to treat foreign and domestic banks alike on branching issues. Though support is not unanimous within the Senate, its version of the bill gives states the authority to block foreign bank branching. The whole issue is further complicated by its overlap with fair trade and national treatment issues, which could potentially involve other Congressional committees, like Ways and Means and Energy and Commerce.

In trying to reach a compromise on this issue, two senators have proposed extending CRA to non-deposit-taking foreign institutions. This proposal has the potential to derail the whole interstate banking/branching bill. Why? Because extending CRA to a non-federally insured financial institution would set a precedent for extending CRA to other nonbanks like insurance companies, a precedent that many Congressmen would find unacceptable.

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Thomas A. Pollmann provided research assistance. The author would like to thank Ellen C. Lamb of the Conference of State Bank Supervisors for helpful comments and suggestions.

Endnotes

1. See Mengle (1990) and Wheelock (1993) for details on the history of interstate banking and branching restrictions. [back to text]
2. "Generally" is an important qualifier because there are some notable exceptions. In the early 1980s, for example, Congress gave bank holding companies the authority to acquire large failing out-of-state banks, regardless of state interstate banking restrictions. See Savage (1993). [back to text]
3. A bank holding company is a corporation that controls at least one bank, frequently referred to as a bank subsidiary. [back to text]
4. See Mengle (1990) for a detailed historical account of branching restrictions in the United States. [back to text]
5. For an excellent discussion of the expected benefits for consumers and small businesses from interstate banking/branching legislation, see Calem (1993). [back to text]
6. According to the U.S. Census Bureau, there were 30 metropolitan statistical areas (MSAs) and seven primary MSAs (PMSAs) that crossed state borders as of December 31, 1992. [back to text]
7. Though the existence of huge ATM networks has filled part of this void, there are still many transactions that are not possible or are quite costly (in terms of fees) with ATMs. [back to text]
8. See Rhoades and Savage (1993) for a discussion of the costs and benefits of the various organizational structures in banking. [back to text]
9. See Savage (1993) and U.S. GAO (1993) for a review of concentration measures. [back to text]
10. For information on how a merger is reviewed for competitive effects, see U.S. GAO (1993), pp. 129-40. [back to text]

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REGIONAL ECONOMIST | JULY 1994

<https://www.stlouisfed.org/publications/regional-economist/july-1994/emlaissez-le-bon-temps-rouletteem-letting-the-good-times-roll-on-riverboat-casinos>

Laissez le Bon Temps Roulette: Letting the Good Times Roll on Riverboat Casinos

Adam M. Zaretsky

Until 1990, casino gambling was legal only in Nevada and Atlantic City, N.J. Since then, it has been authorized in 23 states, including four in the Eighth Federal Reserve District. In a quest to raise revenues without imposing additional taxes on the populace, these states have approved casino gambling, touting that new jobs will be created and additional monies will be made available for education.

Iowa, which was the first Midwestern state to approve riverboat gambling, found it to be quite successful. Illinois, Missouri, Indiana and Mississippi have now followed Iowa's lead and passed riverboat gambling initiatives. The degree of success of these operations varies by state and depends on the concentration of nearby competition. Because gambling is too new in Indiana and Missouri, riverboats in Illinois and Mississippi are the centerpieces for our District. Arkansas, Kentucky and Tennessee have not yet tackled the issue, either in an election or in the legislature.

Illinois

Illinois' first boat opened in September 1991. During its first week of operation, which was only five days long, 7,130 people attended, and adjusted gross receipts—after payouts for winnings—were about \$296,000. Of this total, about \$73,500 was paid in state and local taxes: Illinois requires two dollars of the admission fee go to the state and locality (one dollar to each) and imposes a wagering tax—15 percent to the state, 5 percent to the locality—on the adjusted gross receipts.

At the end of 1991, with two riverboats operating, adjusted gross revenues in Illinois were almost \$15 million, with more than \$3.5 million in taxes going to government agencies. By 1993, Illinois had 10 riverboats, with revenues of almost \$606 million. During the first quarter of 1994, 12 riverboats produced revenues of slightly more than \$217 million, about \$10 million less than receipts for all of 1992, and logged more than four million visitors. If attendance and revenues continue on this path for the remainder of the year, the state can expect to collect wagering taxes of almost \$175 million and admissions taxes of about \$34 million.

Illinois law does not allow dockside gambling, unless circumstances prevent the boats from cruising, nor does it include a loss-limit—the maximum amount an individual can lose during a gambling excursion. This certainly gives its casinos an advantage over those that are subject to a loss-limit in neighboring states, like Missouri.

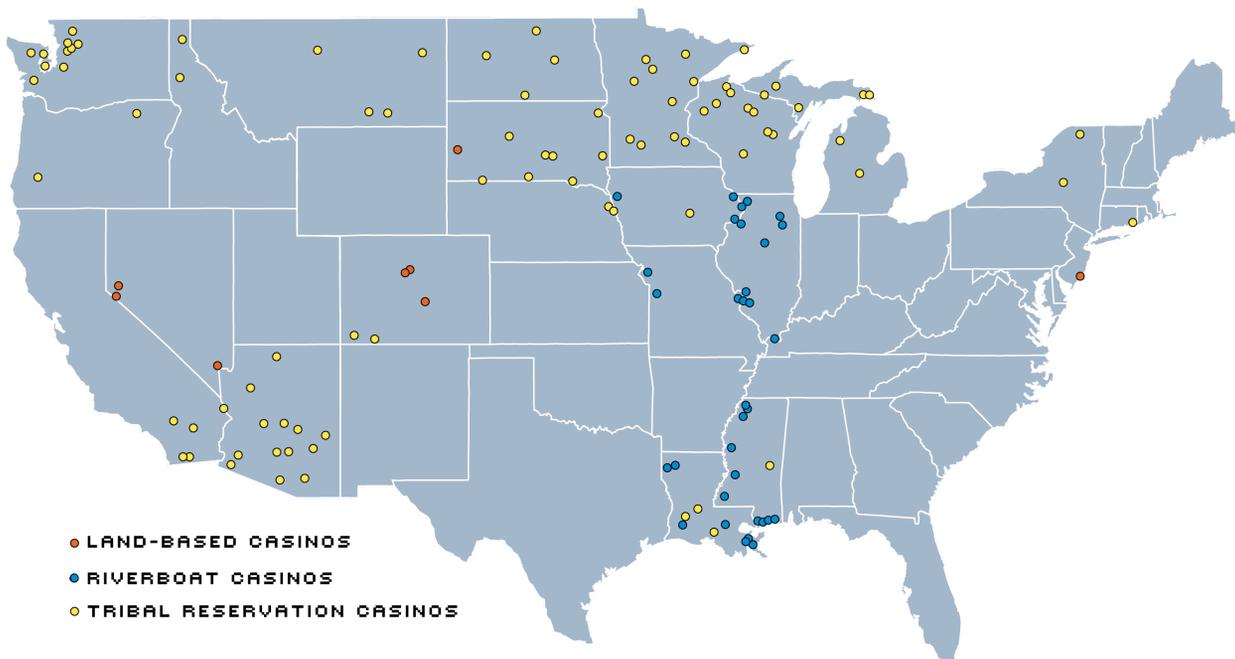
Missouri

Voters approved Missouri's riverboat gambling referendum in November 1992, and plans were immediately hatched to place riverboats in the St. Louis and Kansas City metropolitan areas. Opponents of gambling, however, filed suit, questioning whether games of chance—slot machines, craps, roulette, etc.—were constitutional in the state. The state Supreme Court said no, thereby requiring a constitutional amendment to

allow such games on the boats. In April 1994, the amendment failed by the narrowest margin in state history. A recount was requested by the pro-gambling campaign, but the outcome was a wider margin of defeat for the amendment. In response, the state legislature legally redefined games of skill to include craps, video poker and video blackjack. This law is expected to face a court challenge, but, until then, riverboats have opened to offer games of skill.

Missouri imposes admission and wagering taxes similar to Illinois'. The state receives 18 percent and the locality receives 2 percent of adjusted gross revenues; two dollars of the admission fee are turned over to the state gaming commission, which keeps one and gives one to the locality. Also like Illinois, Missouri does not allow dockside gambling.¹ It does, however, impose a loss-limit of \$500 per excursion on individuals. This provision superficially appears to handicap Missouri casinos against their counterparts in neighboring states where loss-limits do not exist. The provision's effectiveness is blunted, though, because it applies only to a single excursion: Individuals need only pay an additional admission fee for further excursions to continue playing. What this will mean for revenues remains to be seen, particularly because many of the plans, especially in St. Louis, call for extensive land-based building—for example, hotels—in conjunction with the riverboats, which will raise other revenues for the state.

Casino Gambling in the United States



NOTES: Nevada has about 2,200 gambling establishments in all counties. The three major sites are "pinned" on the map. Alaska and Hawaii currently do not have casino gambling. Tribal reservation information is current through May 2, 1994. Land-based and riverboat casino information is current through June 24, 1994.

SOURCES: Land-based and riverboat casinos: State departments of gaming or state gaming commissions. Tribal reservation casinos: National Indian Gaming Commission.

Indiana

Indiana enacted its gambling law in July 1993, allowing individual counties and municipalities to ask voters if they want riverboats in their area. Currently, the Indiana Gaming Commission has only five licenses to grant to Ohio River communities; six counties, across the river from Cincinnati and Louisville, have already passed referendums. The first boat is expected to open by the end of this year. As in the other states, Indiana will impose admission and wagering taxes on the casinos. The state retains 15 percent of adjusted gross revenues, and the local and county governments each get 2 ½ percent. Of the \$2.50 admission tax, one dollar each goes to each the local and county governments, and 50 cents goes to the state. Unlike Missouri, Indiana does not have a loss-limit provision. As in Illinois and Missouri, dockside gambling is allowed at the boat captain's discretion for safety. This allowance for dockside gambling, though, is still more restrictive than that in other states, for example, Mississippi.

Mississippi

Mississippi's first boat opened in August 1992 in Biloxi. By the end of 1992, five boats had opened, four on the Gulf Coast and one on the Mississippi River in Tunica County. In 1993, another 12 boats opened for business, four of them in Tunica. This year, nine more boats opened by June, three in Tunica. Mississippi is now second to Las Vegas in total square footage of gaming space. By July 1995, the state predicts there will be more than 40 riverboats operating in the state. Tunica County alone has at least five more casinos slated to open this year and has transformed itself from one of the poorest counties in the nation to one of the fastest growing.

Unlike other states, Mississippi allows dockside gambling. Thus, operating costs for the riverboats are dramatically reduced because they do not incur the costs of cruising on the river. Many boats, in fact, do not even have engines or wheelhouses. In addition, Mississippi does not impose a loss-limit on individuals. This has led to Mississippi raising more gambling revenues than any other state except Nevada and New Jersey. For example, in 1993, with 17 boats operating by the end of the year, Mississippi boats' adjusted gross revenues were about \$790 million. In Illinois, 10 boats in 1993 had adjusted gross revenues of about \$606 million.

Mississippi also has a more complex taxing scheme—it imposes a progressive rather than a flat wagering tax. Essentially, the state collects an increasing percentage of monthly adjusted gross revenues: 4 percent on the first \$50,000, 6 percent on the next \$84,000, and 8 percent on anything above \$134,000. Local taxes follow the same scheme with much lower rates, and individual counties and cities make different provisions.

Much of this fanfare may cool because of the riverboat casinos in Louisiana, especially those in the New Orleans area. On top of this, a land-based casino, which is a greater revenue generator than a riverboat, will soon open in New Orleans. Direct competition with these facilities, however, will affect the Gulf Coast boats before it reaches those up north. New Orleans' greater ability to attract visitors because of convention and sporting facilities, as well as the city's well-known appeal as a tourist destination, will hurt Mississippi, but the extent of the effect remains to be seen. Until then, Mississippi has a head start and the experience its competition does not.

Thomas A. Pollmann provided research assistance.

Endnotes

1. There is one exception in St. Louis for a boat that does not move under its own power. [back to text]



REGIONAL ECONOMIST | JULY 1994

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Pieces of Eight: News Bulletins from the Eighth Federal Reserve District

The Rise of Long-Term Bond Yields

Since the 1950s, the long-term Treasury bond yield has roughly mirrored the upward and downward movements in inflation. Recently, however, long-term yields have increased while inflation has decreased. Analysts and forecasters are puzzled. What is causing long-term interest rates to rise?

In the current issue of *Annual U.S. Economic Data*, St. Louis Fed research director William G. Dewald examines the relationship between long-term interest rates and inflation and concludes that the increase in long-term rates is due to the anticipated increase in inflation by many investors.

For more details on his analysis, please call Debbie Dawe at 314-444-8809 and request a copy of the 1994 issue of *Annual U.S. Economic Data*.

Why the Trade Deficit with Japan Isn't Shrinking

Despite previous movements in the dollar's real exchange value relative to the yen that should have reduced the U.S. trade deficit with Japan, the deficit continues to grow. In fact, in 1993, the trade deficit reached a record high of \$59.3 billion. Why isn't the U.S. trade deficit with Japan shrinking?

According to Fed economist Patricia S. Pollard, one reason is the relative strengths of the U.S. and Japanese economies. In the past two years, the U.S. economy has grown faster than the Japanese economy. As a result, she says, U.S. spending on imports from Japan has increased, while Japanese spending on U.S. exports has decreased. Thus, the effects of exchange rate movements on this bilateral trade deficit have been more than offset by the weakness of the Japanese economy.

"As the Japanese economy recovers from its current recession, however, the U.S. trade deficit with Japan should begin to shrink," adds Pollard.

To request a copy of the May 1994 issue of *International Economic Conditions*, please call 314-444-8809.

Extra! Extra! Read All About It!

The publication you're reading is just one of several free research publications produced by the Federal Reserve Bank of St. Louis. Here, briefly, is a description of several other research publications that are available.

- *Review*—A bimonthly economics journal containing articles about national and international economic issues.

- *Monetary Trends*—A monthly publication containing charts and tables on U.S. monetary and reserve aggregates, savings and time deposits, and commercial bank loans.
- *National Economic Trends*—A monthly publication containing charts and tables on U.S. output and income, employment, inflation and selected budget measures.
- *International Economic Conditions*—A quarterly publication (plus an annual edition) containing data on U.S. transactions with the rest of the world, as well as data on the quantity of money, inflation, unemployment, real GDP, merchandise trade, interest rates and exchange rates for leading countries.
- *Annual U.S. Economic Data*—An annual publication containing monetary and business data, including closely watched production, employment and price series.

All publications also include a brief analysis of a current issue. Single subscriptions to these publications are available free of charge. To subscribe to a publication or to find out more information, call Debbie Dawe at 314-444-8809 or Cindy Davis at 314-444-8808.

Percentage Rate of Business Closings from October 1991 to September 1992

Rank Among 50 States	District State	Percent of Businesses Closing
6	Illinois	11.71%
18	Missouri	13.20
19	Arkansas	13.54
21	Indiana	13.59
30	Kentucky	14.84
37	Mississippi	15.56
38	Tennessee	15.84

SOURCE: U.S. Department of Labor

District Data

Selected economic indicators of banking,
agricultural and business conditions in
the Eighth Federal Reserve District

The Regional Economist
July 1994

Commercial Bank Performance Ratios

U.S., District and State

	All U.S.	U.S. <\$15B ¹	District	AR	IL	IN	KY	MS	MO	TN
Return on Average Assets (Annualized)										
1st quarter 1994	1.15%	1.27%	1.24%	1.28%	1.24%	1.06%	1.24%	1.22%	1.23%	1.33%
4th quarter 1993	1.21	1.26	1.27	1.40	1.39	1.17	1.12	1.31	1.23	1.29
1st quarter 1993	1.23	1.22	1.23	1.49	1.49	1.32	0.84	1.52	1.14	1.26
Return on Average Equity (Annualized)										
1st quarter 1994	14.69%	14.79%	14.46%	13.99%	12.77%	11.23%	14.18%	13.28%	15.49%	17.11%
4th quarter 1993	15.55	14.99	14.86	15.51	14.60	12.53	13.20	14.28	15.50	16.76
1st quarter 1993	16.08	14.82	14.58	16.72	15.85	14.33	9.93	16.54	14.45	16.87
Net Interest Margin (Annualized)										
1st quarter 1994	3.85%	4.03%	3.68%	3.55%	3.63%	3.67%	3.73%	3.99%	3.57%	3.89%
4th quarter 1993	4.48	4.86	4.52	4.51	4.82	4.43	4.43	4.97	4.34	4.62
1st quarter 1993	4.50	4.81	4.47	4.49	4.56	4.40	4.34	4.97	4.35	4.59
Nonperforming Loans² ÷ Total Loans										
1st quarter 1994	1.86%	1.53%	0.82%	0.83%	1.14%	0.57%	0.78%	0.82%	0.77%	0.84%
4th quarter 1993	1.98	1.60	0.85	0.87	1.20	0.61	0.73	0.84	0.84	0.90
1st quarter 1993	2.93	2.15	1.23	1.07	1.47	0.86	1.23	1.09	1.35	1.22
Net Loan Losses ÷ Average Total Loans (Annualized)										
1st quarter 1994	0.46%	0.41%	0.16%	0.12%	0.25%	0.09%	0.24%	0.12%	0.07%	0.28%
4th quarter 1993	0.83	0.71	0.37	0.15	0.44	0.19	0.47	0.35	0.35	0.49
1st quarter 1993	0.82	0.70	0.40	0.10	0.36	0.23	0.50	0.45	0.46	0.52
Loan Loss Reserve ÷ Total Loans										
1st quarter 1994	2.43%	2.19%	1.77%	1.58%	1.79%	1.53%	1.69%	1.77%	1.94%	1.86%
4th quarter 1993	2.43	2.20	1.76	1.56	1.78	1.49	1.65	1.72	1.96	1.87
1st quarter 1993	2.67	2.41	1.84	1.67	1.87	1.49	1.76	1.76	1.95	2.12

NOTE: Data include only that portion of the state within Eighth District boundaries.

¹ U.S. banks with average assets of less than \$15 billion are shown separately to make comparisons with District banks more meaningful, as there are no District banks with average assets greater than \$15 billion.

² Includes loans 90 days or more past due and nonaccrual loans

SOURCE: FFIEC Reports of Condition and Income for Insured Commercial Banks

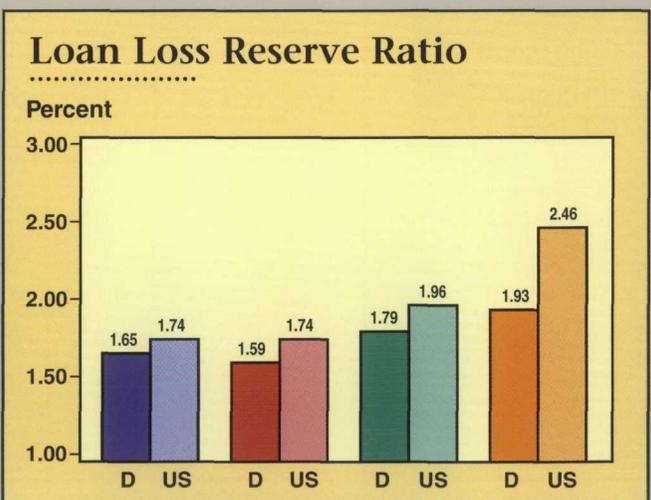
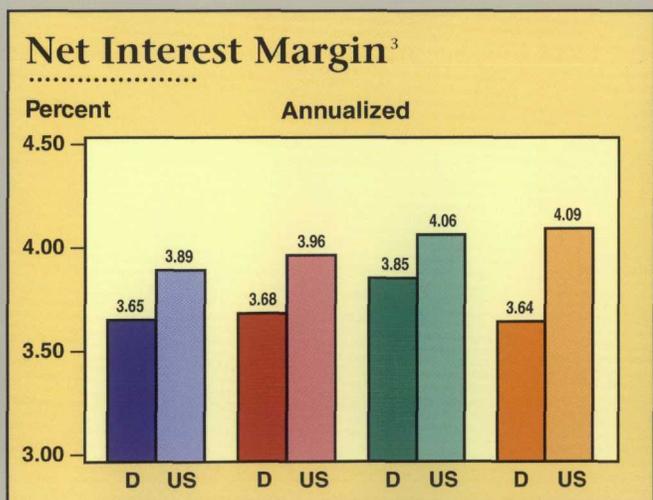
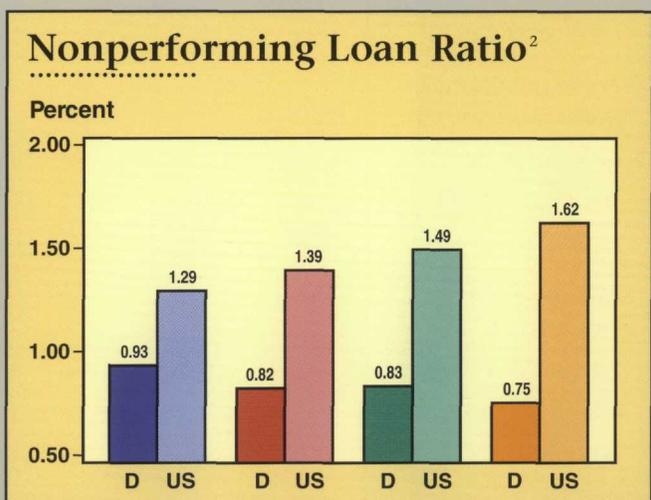
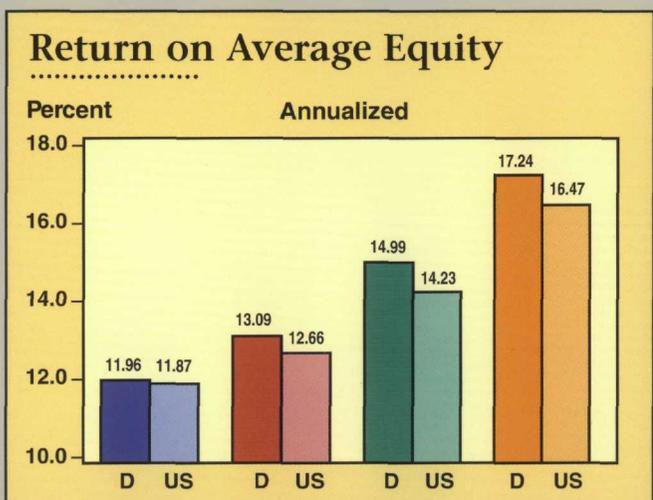
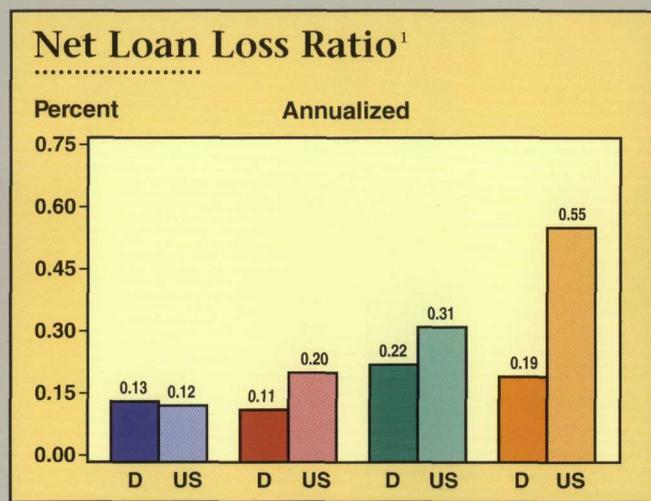
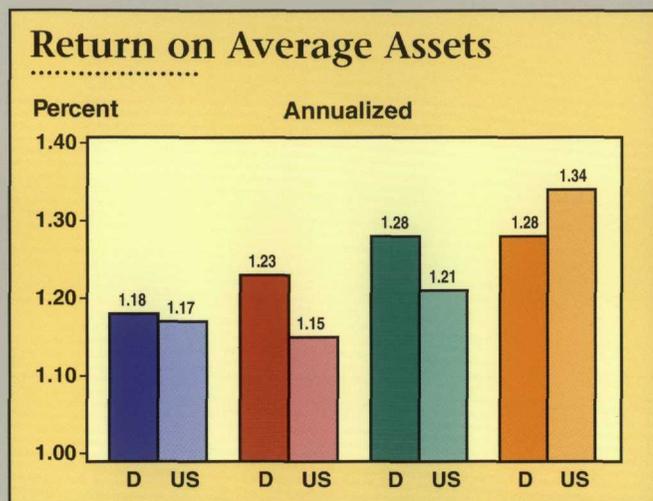
Commercial Bank Performance Ratios

by Asset Size

1st Quarter 1994

Earnings

Asset Quality



D = District	< \$100 Million	\$300 Million - \$1 Billion
US = United States	\$100 Million - \$300 Million	\$1 Billion - \$15 Billion

NOTE: Asset quality ratios are calculated as a percent of total loans.

¹ Loan losses are adjusted for recoveries

² Includes loans 90 days or more past due and nonaccrual loans

³ Interest income less interest expense as a percent of average earning assets

SOURCE: FFIEC Reports of Condition and Income for Insured Commercial Banks

Agricultural Bank Performance Ratios

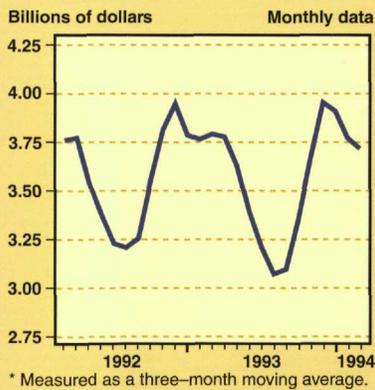
	U.S.	AR	IL	IN	KY	MS	MO	TN
Return on average assets (annualized)								
1st quarter 1994	1.23%	1.19%	1.13%	1.29%	1.32%	1.47%	1.30%	1.14%
4th quarter 1993	1.27	1.29	1.21	1.20	1.24	1.47	1.33	1.02
1st quarter 1993	1.38	1.48	1.38	1.30	1.40	1.54	1.49	1.29
Return on average equity (annualized)								
1st quarter 1994	12.24%	11.28%	10.93%	12.25%	13.47%	13.94%	13.20%	10.95%
4th quarter 1993	12.78	12.34	11.78	12.01	12.76	14.10	13.52	9.53
1st quarter 1993	14.25	14.31	13.68	13.01	14.90	15.38	15.69	12.29
Net interest margin (annualized)								
1st quarter 1994	3.68%	3.44%	3.31%	3.91%	3.69%	4.00%	3.69%	3.40%
4th quarter 1993	4.60	4.44	4.24	4.76	4.46	5.25	4.61	4.49
1st quarter 1993	4.58	4.38	4.23	4.55	4.50	5.09	4.59	4.55
Ag loan losses ÷ average ag loans (annualized)								
1st quarter 1994	0.02%	0.63%	0.02%	-0.07%	-0.05%	0.04%	0.19%	-0.05%
4th quarter 1993	0.19	0.29	0.17	-0.23	0.30	1.04	0.43	0.11
1st quarter 1993	0.10	0.20	0.21	0.07	0.01	0.51	0.46	7.81
Ag nonperforming loans¹ ÷ total ag loans								
1st quarter 1994	1.53%	1.04%	1.69%	0.24%	1.62%	4.91%	1.15%	0.19%
4th quarter 1993	1.30	0.79	1.87	1.03	1.25	3.24	0.71	0.00
1st quarter 1993	2.07	1.37	3.25	2.70	2.03	6.25	2.03	2.98

NOTE: Agricultural banks are defined as those banks with a greater than average share of agricultural loans to total loans.
Data include only that portion of the state within Eighth District boundaries.

¹ Includes loans 90 days or more past due and nonaccrual loans

SOURCE: FFIEC Reports of Condition and Income for Insured Commercial Banks

U.S. Agricultural Exports*



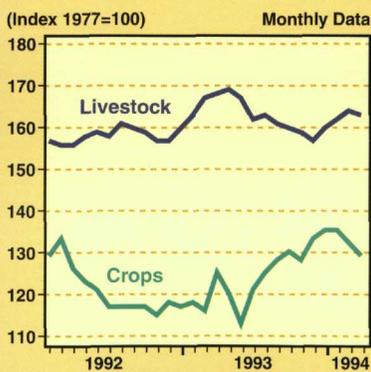
U.S. Agricultural Exports by Commodity

Dollar amounts in billions

Commodity	Jan	Feb	Mar	Year-to-date	Change from year ago
Livestock & products	.63	.59	.75	4.06	25.1%
Corn	.33	.28	.36	2.22	-6.2
Cotton	.21	.15	.23	.97	11.6
Rice	.07	.08	.10	.46	19.5
Soybeans	.51	.49	.39	2.88	-9.2
Tobacco	.11	.14	.10	.67	-18.5
Wheat	.39	.32	.33	2.21	-12.5
TOTAL ¹	3.74	3.48	3.92	22.99	-0.9

¹ Includes commodities not listed here

U.S. Crop and Livestock Prices



Indexes of Food and Agricultural Prices

	Level			Growth ¹	
	I/94	IV/93	I/93	IV/93-I/94	I/93-I/94
Prices received by U.S. farmers	148	145	140	8.6	5.7
Prices received by District farmers ²					
Arkansas	136	129	120	22.3	13.6
Illinois ³	107	104	97	12.0	11.0
Indiana	123	116	107	29.3	15.6
Missouri	143	136	135	19.9	5.7
Tennessee	149	141	143	24.8	4.2
Prices paid by U.S. farmers					
Production items	181	181	176	0.0	2.8
Other items ⁴	198	196	192	4.1	3.1
Consumer food prices	143	143	140	0.5	2.4
Consumer nonfood prices	147	146	144	2.5	2.5

NOTE: Data not seasonally adjusted except for consumer food prices and nonfood prices.

¹ Compounded annual rates of change are computed from unrounded data.

² Index of prices received for all farm products (1977=100). Indexes for Kentucky and Mississippi are unavailable.

³ (1987-91=100) for 1993; (1988-92=100) for 1994

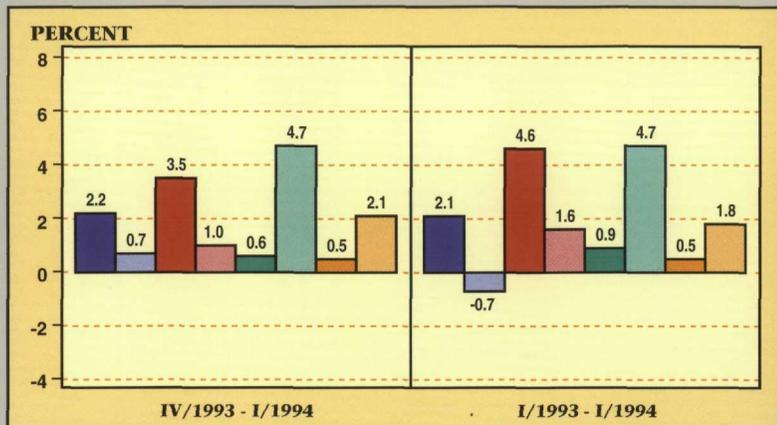
⁴ Other items include commodities, services, interest, taxes and wages.

Selected U.S. and State Business Indicators

United States

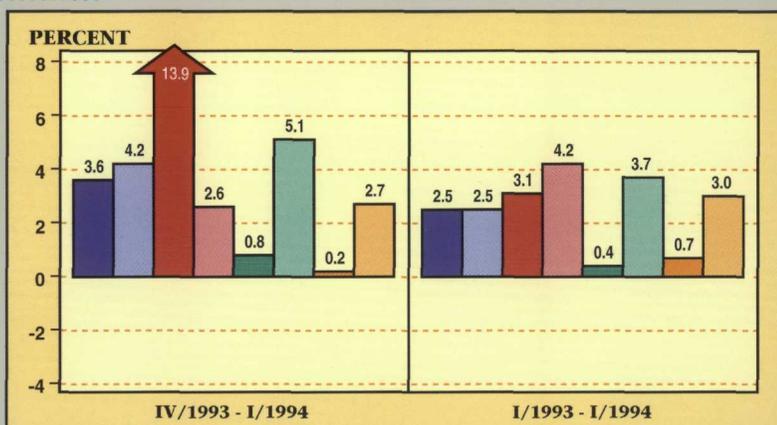
	I/1994	IV/1993	I/1993
Labor force (in thousands)	130,674	128,713	127,355
Total nonagricultural employment (in thousands)	111,976	111,363	109,717
Unemployment rate	6.6%	6.5%	7.0%
	IV/1993	III/1993	IV/1992
Real personal income* (in billions)	\$3,761.2	\$3,723.4	\$3,738.7

Compounded Annual Rates of Change in Nonagricultural Employment



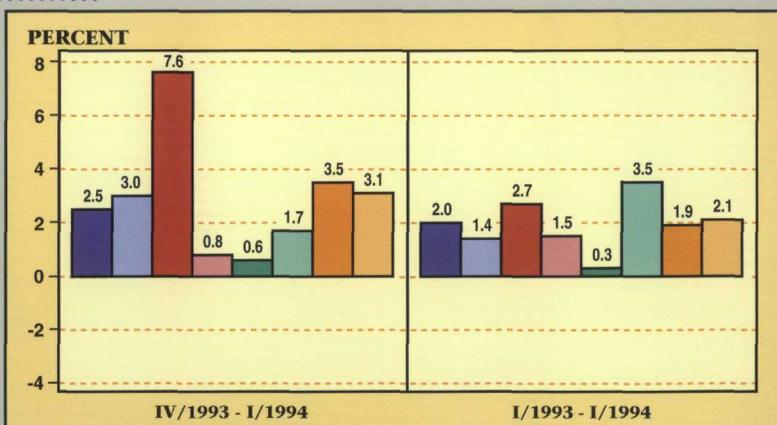
Arkansas

	I/1994	IV/1993	I/1993
Labor force (in thousands)	1,201.7	1,167.3	1,158.7
Total nonagricultural employment (in thousands)	1,005.4	996.6	980.7
Unemployment rate	5.2%	6.0%	6.4%
	IV/1993	III/1993	IV/1992
Real personal income* (in billions)	\$27.4	\$26.8	\$27.2



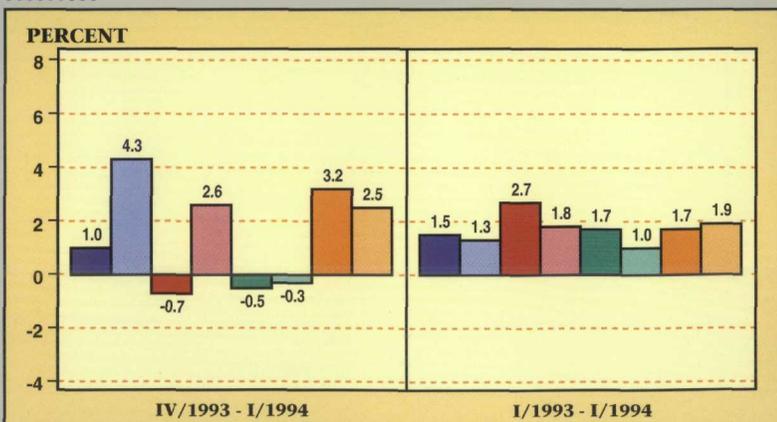
Illinois

	I/1994	IV/1993	I/1993
Labor force (in thousands)	6,047.3	5,967.0	5,968.9
Total nonagricultural employment (in thousands)	5,392.6	5,359.0	5,286.0
Unemployment rate	6.3%	6.4%	7.5%
	IV/1993	III/1993	IV/1992
Real personal income* (in billions)	\$185.8	\$182.9	\$184.5



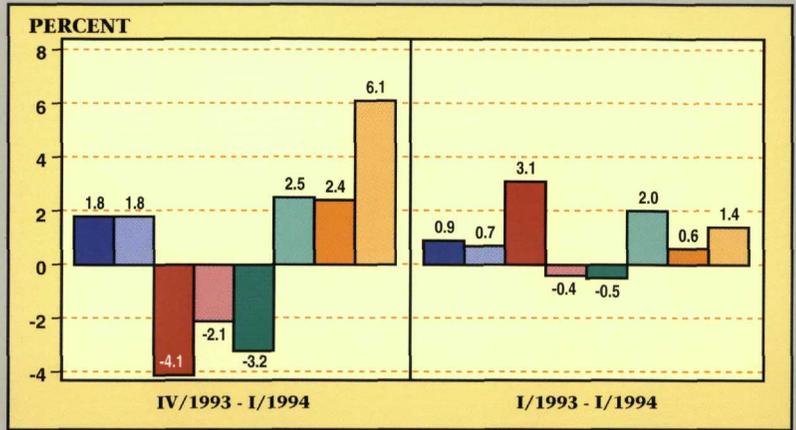
Indiana

	I/1994	IV/1993	I/1993
Labor force (in thousands)	3,009.3	2,986.3	2,885.8
Total nonagricultural employment (in thousands)	2,624.4	2,618.2	2,586.2
Unemployment rate	5.2%	5.1%	5.7%
	IV/1993	III/1993	IV/1992
Real personal income* (in billions)	\$76.9	\$76.0	\$75.7



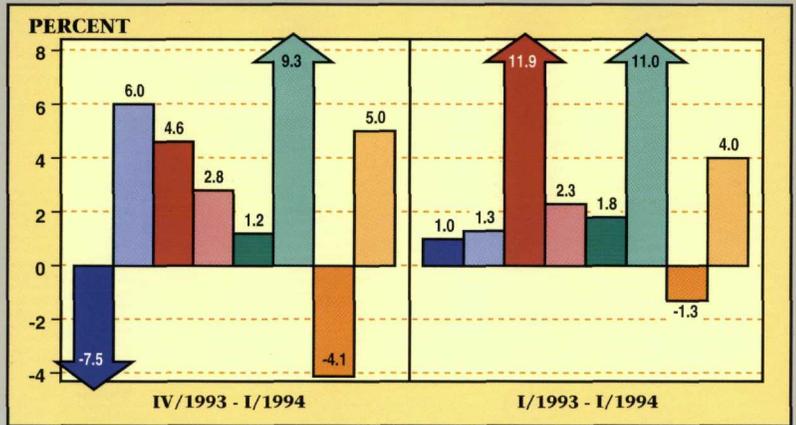
Kentucky

	I/1994	IV/1993	I/1993
Labor force (in thousands)	1,810.6	1,790.4	1,795.8
Total nonagricultural employment (in thousands)	1,546.5	1,539.5	1,532.1
Unemployment rate	4.9%	6.0%	6.2%
	IV/1993	III/1993	IV/1992
Real personal income* (in billions)	\$45.7	\$45.3	\$45.1



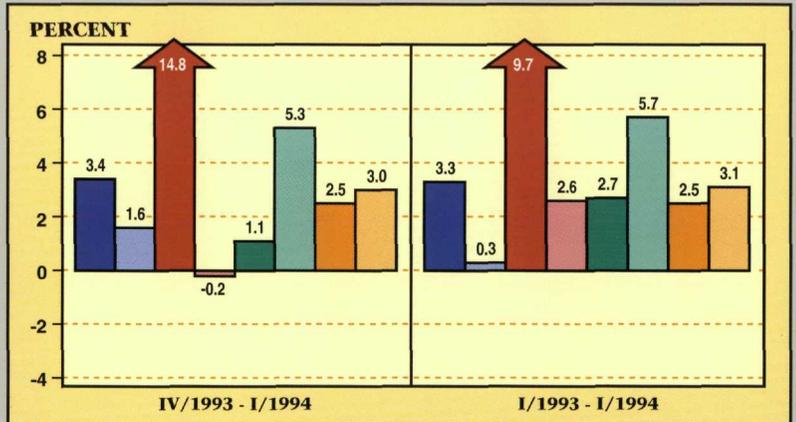
Mississippi

	I/1994	IV/1993	I/1993
Labor force (in thousands)	1,219.0	1,219.7	1,198.4
Total nonagricultural employment (in thousands)	1,003.2	1,023.0	993.6
Unemployment rate	6.9%	6.0%	6.6%
	IV/1993	III/1993	IV/1992
Real personal income* (in billions)	\$27.7	\$27.3	\$26.6



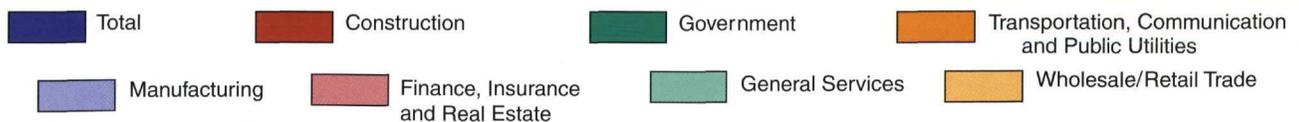
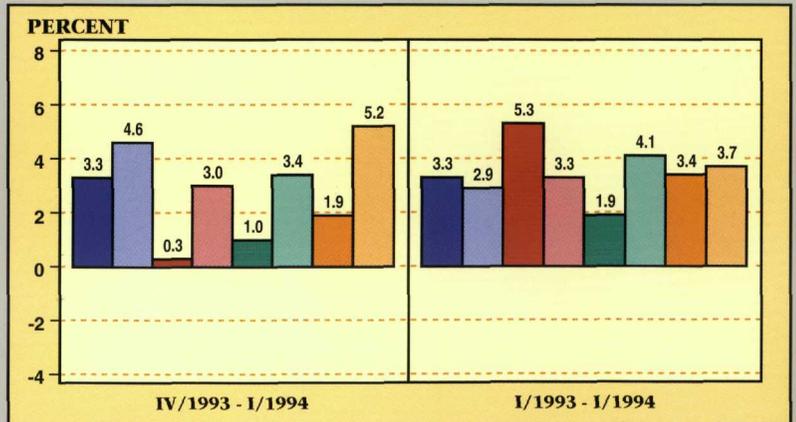
Missouri

	I/1994	IV/1993	I/1993
Labor force (in thousands)	2,649.5	2,659.4	2,642.4
Total nonagricultural employment (in thousands)	2,444.7	2,424.2	2,365.9
Unemployment rate	5.6%	6.5%	6.1%
	IV/1993	III/1993	IV/1992
Real personal income* (in billions)	\$71.4	\$69.5	\$71.2



Tennessee

	I/1994	IV/1993	I/1993
Labor force (in thousands)	2,601.8	2,517.6	2,475.7
Total nonagricultural employment (in thousands)	2,374.0	2,354.7	2,298.4
Unemployment rate	5.5%	5.4%	5.8%
	IV/1993	III/1993	IV/1992
Real personal income* (in billions)	\$65.9	\$65.4	\$65.1



NOTE: All data are seasonally adjusted. The nonagricultural employment data reflect the 1993 benchmark revision.
* Annual rate. Data deflated by CPI, 1982-84=100.