BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ANDREW F. BRIMMER
MEMBER OF THE BOARD

October 20, 1969

The Honorable Arthur F. Burns
Counsellor to the President
Executive Office Building
Washington, D. C. 20500

Dear Arthur:

I simply wanted to send you a note of congratulations upon your prospective appointment as a member and Chairman of the Board of Governors of the Federal Reserve System upon the expiration of Chairman Martin's term as a member of the Board.

Since you know this System as well as anyone who has not actually served in it -- and since all of us know you at least to some degree -- I am certain that we can look forward to working together in an hospitable environment.

Again, I simply wanted to say welcome.

Sincerely yours,

Rudy

Called 11/3/69

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ANDREW F. BRIMMER
MEMBER OF THE BOARD

January 26, 1970.

TO: The Honorable Arthur F. Burns

SUBJECT: Improving Interagency Coordination of International Monetary and Financial Policy through the NAC.

As I indicated in our luncheon discussion, I think that it is important that steps be taken to improve the coordination of policy formulation and implementation through the National Advisory Council on International Monetary and Financial Policy (NAC).

As you may recall, the NAC was originally created by legislation to meet the need for inter-agency coordination in the international financial field. It is chaired by the Secretary of the Treasury. Other members are the Secretaries of State and Commerce, the President of the Export-Import Bank, and the Chairman of the Federal Reserve Board. Each of the members of the Council has an alternate, and most of the day-to-day decisions are now made by the alternates rather than by the principals. The Alternates for Treasury, State and Commerce are Assistant Secretaries, and for Ex-Im Bank and the Federal Reserve they are Board Members. As I mentioned, I am the Alternate for the Federal Reserve.

Other agencies that regularly or occasionally participate in NAC meetings are Defense, Agriculture, Bureau of the Budget and the Council of Economic Advisers.

The NAC has a staff committee which meets every week. Each member Agency has a representative on this committee. The secretariat for the NAC is maintained by the Treasury Department.

The NAC has advisory responsibility for U. S. policy with respect to foreign lending by U. S. agencies and the lending activities of the IMF, the World Bank Group, the Inter-American Development Bank and the Asian Development Bank. It is the formal link which enables the Federal Reserve to participate in policy and lending decisions which may be of great importance to us from the point of view of the balance-of-payments.

Unfortunately, the NAC sometimes is unable to perform its intended function of giving all interested agencies an opportunity to contribute to the formulation of policies in which they have an interest. For example, last month an NAC alternates' meeting was called to discuss the U. S. policy with respect to replenishment of the resources of the International Development Association. We discussed the position that the U. S. would take at a meeting of the donor countries to be convened in Paris a few days later. But it was apparent that the United States' position had already been agreed upon by Treasury and State without any staff work or consultation involving the other NAC agencies. The NAC alternates were expected merely to ratify what had already been decided. Yet, this is a question that has obvious balance-of-payments implications and is therefore of interest to the Federal Reserve. Also, when and if a recommendation is made to Congress that it appropriate funds for the replenishment, each NAC principal will be asked personally to sign a report to Congress recommending whatever the NAC agrees upon. It would seem appropriate, therefore, that each of the other NAC agencies should have had a voice in formulating the policy.

Another example of short-circuiting is the decision to untie U. S. aid to Latin America. In this case, the decision was made without either consultation with all the NAC agencies or any formal ratification of the policy change by them. Without going into the merits of the decision, I believe the problem should have been assigned to the NAC for study with a view to taking advantage of the experience and judgment of the NAC agencies.

A third example relates to U. S. policy on rescheduling debts owed to the United States by Latin American countries. A specific technique to deal with this problem was proposed in Governor Rockefeller's Latin American report, and the President endorsed it publicly at a press conference. Subsequently the NAC was asked to study this technical proposal with a view to adopting it in appropriate cases. But before the NAC could complete this task, a broader plan, also growing out of the Rockefeller report, calling for extensive use of debt rescheduling as a way of giving foreign aid, was formulated at high levels and was submitted to the President without having received the benefit of NAC advice. The NAC staff has had considerable experience with debt rescheduling, and its advice on this subject undoubtedly would have been of some value in formulating the broad plan as well as in reaching the decision to endorse the Rockefeller technical proposal.

The NAC can draw on the best expertise to be found in the Government in the international financial field in carrying out its advisory and coordinating functions. There is no reason why this expertise should be lost to the Government. Clearly the Secretary of the Treasury--and certainly the President--need not follow the advice of the NAC, but they should have the advantage of it. If it were made clear that the NAC is expected to function at a high level, there is no doubt that the NAC agencies would respond.

I realize, of course, that most of the agencies--and the White House--have fairly new staffs. Thus, it might be desirable to familiarize these staffs with the NAC machinery and to devise ways in which they might make better use of it. It might also be advisable to re-examine the way in which the NAC itself operates to determine how it might improve its contributions to the decision-making process in the area of international monetary and financial affairs.

Sincerely,

Andrew F. Brimmer

Andrew F. Brimmer,
Alternate Member,
National Advisory Council

For Release on Delivery
Friday, February 6, 1970
12:00 Noon, E.S.T.



# MONETARY POLICY, INTEREST RATE CEILINGS, AND THE ACCESS OF STATE AND LOCAL GOVERNMENTS TO THE CAPITAL MARKETS

Remarks

By

Andrew F. Brimmer
Member
Board of Governors of the
Federal Reserve System

Before the Mid-Year Meeting

of the

Maryland State Bar Association

Lord Baltimore Hotel
Baltimore, Maryland

February 6, 1970

MONETARY POLICY, INTEREST RATE CEILINGS, AND THE ACCESS OF STATE AND LOCAL GOVERNMENTS TO THE CAPITAL MARKETS

By
Andrew F. Brimmer*

In 1969, for the first time in a decade, a significant decline occurred in the volume of long-term borrowing by State and local governments. On the basis of preliminary data, such borrowing may have totaled just under $12 billion last year. This level represents a drop of $4-1/2 billion from the $16.4 billion recorded in 1968. In 1960, about $7.2 billion of long-term municipal bonds were sold; and in all except one year of the decade, the volume rose steadily. While an interruption in the uptrend occurred in 1966, the decrease in that year was only 5 per cent -- compared with a drop of over one-quarter last year.

The relative decline in the participation of State and local governments in the capital market last year can also be traced in the Federal Reserve Board's flow of funds statistics. According to our preliminary estimates, the net volume of funds raised by all nonfinancial sectors in 1969 amounted to about $85.6 billion, a decrease of $11.8 billion

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*Member, Board of Governors of the Federal Reserve System. I am grateful to several persons on the Board's staff for assistance in the preparation of these remarks. Miss Eleanor Pruitt coordinated the collection and analysis of data on statutory interest rate ceilings and borrowing experiences of State and local governments. Mr. Darwin Beck did the preliminary analysis of member bank holdings of State and local securities in selected States. Mr. Peter J. Feddor designed and carried out the computer programming which permitted this analysis of the banks' holdings. In each Federal Reserve Bank, at least one staff member made an informal survey of the most important local governments to obtain information on statutory interest rate ceilings and recent borrowing experience.

(or 12 per cent) from the level in the previous year. However, this decline in the total was more than accounted for by the change in the position of the Federal Government. In calendar year 1969, the latter made net repayments of $5.4 billion -- compared with net borrowings of $13.4 billion in the previous year. So the year-to-year change was a decrease of $18.8 billion.

Allowing for the experience of the Federal Government, total funds raised by other nonfinancial sectors in 1969 amounted to $91.0 billion, representing an expansion of $6.9 billion (or 8 per cent) over the level raised in 1968. However, the net amount of funds raised by State and local governments in 1969 shrank by $1.1 billion, (or by 11 per cent). In contrast, net funds raised by them rose by $2.2 billion (or by 28 per cent) in 1968. Moreover, the decrease of $1.1 billion in net funds raised by State and local units last year represented more than four-fifths of the decline of $1.3 billion in net debt financing in the capital markets. In fact, State and local government securities were the only issues among the three principal types of capital market instruments to register a significant decline in 1969. Despite the extreme tightness in the mortgage market, total mortgage debt showed a small gain (of $200 million) to $27.2 billion. Mortgages on residential properties rose by $1.2 billion (to $19.9 billion), with the gain divided between $300 million on one-to-four family homes and $900 million on other types of residences. Net funds raised through sales of corporate and foreign bonds showed a modest decline of $100 million in 1969. However, this decline centered entirely in the issues of domestic corporations, where net funds raised through corporate bonds alone declined by $200 million to $12.7 billion.

In terms of the relative access to credit facilities, the share of State and local governments in net funds raised by all non-financial sectors (excluding the Federal Government) declined to about 10 per cent in 1969 from about 12 per cent in the previous year. Their relative position in the capital markets, however, was not sustained quite as well; their share of net funds raised through capital market instruments shrank from just under 20 per cent in 1968 to just over 16 per cent last year.

Thus, whether measured by flow of funds data or by the volume of long-term bond sales, the access of State and local governments to the capital markets weakened considerably in 1969. This weakening can be attributed to a number of factors. Undoubtedly, the decrease (to 38 per cent) in the proportion of borrowing proposals approved by voters and the record level of borrowing costs were both contributing developments. However, statutory interest rate ceilings appear to have been of particular importance. As municipal bond yields rose to an average of 5.72 per cent last year -- from an average of 4.45 per cent in 1968 -- these rate limitations became operative for the first time in many widely scattered areas of the country. Although a number of these jurisdictions took steps to modify applicable ceilings, the moves generally came too late to have much impact on their ability to borrow.

Of course, the experience of State and local governments in the capital markets last year is not at all surprising. Given the need on the part of the Federal Reserve System to pursue a policy of substantial restraint as part of the fight against inflation, a shrinkage in the general availability of credit -- in the face of a continuing strong demand for credit -- would obviously lead to a significant rise in the level of market interest rates. Under these circumstances, it was to be expected that State and local governments, along with other borrowers, would encounter difficulties in their efforts to raise funds. But these difficulties were clearly aggravated because of the rigidities imposed by statutory limitations on the rates of interest many of them could pay on long-term debt.

The detrimental effects of these rate ceilings can be traced in several ways:

- The leading commercial banks (which normally provide a major outlet) turned away to a significant degree from the municipal bond market last year. This was especially true in those States with the lowest ceilings.

- The displacement of State and local issues reached a record level, and here also the impact was proportionately greater among States under the strongest rate limitations.

- State and local governments had to search vigorously for alternative sources of funds: short-term borrowing jumped sharply and a number of borrowers relied more heavily on revenue bonds or other sources where rate ceilings did not apply in particular cases.

- In some instances, special steps (or special persuasion) were undertaken to induce buyers (particularly commercial banks) to purchase newly issued obligations.

- But, despite these diverse efforts, it appears that some jurisdictions may have curtailed current expenditures, and total capital spending by State and local units seems to have moderated in 1969.

In light of these developments -- and given the prospect of a continued strong demand for funds by State and local governments -- the need to eliminate the existing statutory ceiling on interest rates remains as pressing as ever. This need assumes even greater urgency when the expanding demand for funds is set against the decline in the relative attractiveness of tax-exempt securities to commercial banks.

Before examining more closely the behavior of State and local governments in the capital market last year, it would be helpful to analyze the configuration of interest rate ceilings.

## Structure of Statutory Interest Rate Ceilings

At the beginning of this year, the 50 States were almost evenly divided with respect to the presence or absence of statutory limitations on the rates of interest they could pay on long-term debt. However, the situation was quite different a year ago: not only did a sizable majority of States have such ceilings but the average level of maximum rates payable was also considerably lower. During the course of 1969, about a dozen States either removed, suspended or raised the existing ceilings, and at the end of last month another half-dozen States had legislation pending or were planning steps to relax these constraints. In a number of instances, changes were also made last year in the ceilings applicable to obligations of local government units.

To obtain a better appreciation of the structure of interest rate ceilings and their effects on borrowing at the local level, the Federal Reserve Banks were asked in January to make an informal survey of the situation in their Districts. The results of that canvass, when combined with information published by the Daily Bond Buyer, provide a fairly good description of the status of statutory interest rate ceilings at the beginning of this year. The information is shown in some detail in Table 1, attached. The Table distinguishes between ceilings applicable to State governments and those applicable to local units; it also distinguishes among general obligations, revenue bonds and agency issues. The States are listed according to the level of the ceiling applicable to the State's general obligations. As a rule, the local ceilings prevail throughout the State, but in some cases large cities have special ceilings. A few of these are also shown separately.

For convenient reference, the details in Table 1 can be summarized as follows:

| Level of Ceiling (January, 1970) | State Governments | | | Local Governments | | |
|---|---|---|---|---|---|---|
| | General Obligations | Revenue Bonds | State Agency | General Obligations | Revenue Bonds | Local Agency |
| No Ceiling | 24 | 23 | 22 | 19 | 21 | 19 |
| 7 per cent and over | 9 | 7 | 7 | 14 | 13 | 14 |
| 6 to 7 per cent | 11 | 11 | 11 | 15 | 13 | 11 |
| Under 6 per cent | 4 | 4 | 3 | 2 | 0 | 1 |
| Varies | 1 | 1 | 3 | 0 | 1 | 1 |
| Not issued | 1 | 4 | 3 | 0 | 1 | 2 |
| Not authorized | 0 | 0 | 1 | 0 | 1 | 2 |
| Total | 50 | 50 | 50 | 50 | 50 | 50 |

This summary points up several striking features: while almost half the States have no ceilings on general obligations, almost one-third of them have ceilings below 7 per cent -- and in four of the latter the limit is below 6 per cent. As far as States are concerned, the situation appears to be approximately the same with respect to the range of ceilings on all three types of obligations. But among local governments, somewhat more variety is evident. A slightly larger number of States have established maximum interest rate ceilings on the main types of long-term debt issued by local jurisdictions. On the other hand, the average level of the ceilings appears to be somewhat higher.

Impact of Interest Rate Ceilings

If we look behind the summary, however, we can begin to see the influence of the rate limitations on the capital market behavior of State and local governments. The experience of three of the four States with ceilings of less than 6 per cent on general obligations is especially instructive. California -- with a 5 per cent limit -- is the most dramatic example of a State that has suffered because of a low ceiling. It topped the list of States in the volume of bonds displaced in 1969, and one banker estimates that California was able to sell only one-tenth of the bonds needed to finance public projects in that year. In Arkansas, where the rate varies between 5 and 6 per cent and where securities must be sold at par, it is reported that virtually no buyers can be found for city, county and other governmental agency bonds. In fact, it is reported that -- for all practical purposes -- these local units in Arkansas have been out of the capital improvement business for some time. In Kansas, with a 5-1/2 per cent ceiling, the number and dollar volume of issues are both reported to have declined significantly in 1969 compared with the levels reached in the preceding year. It is also reported that both California and Kansas are planning to revise their interest rate ceilings in the near future.

The most striking fact about the eleven States with ceilings on general obligations between 6 and 7 per cent is that about half of them (Colorado, Illinois, Oklahoma, Utah and Virginia) have legislation pending to raise the limit. In the meantime, the adverse effects of the existing ceilings have been substantial. For example, it is reported that Mississippi is finding it almost impossible to sell bonds at the 6 per cent ceiling. Apparently some dealers in the State will take the issues at that rate -- if the government will agree to let them have the use of the funds for a specified amount of time. In Alabama, the city of Birmingham is said to be relying heavily on revenue bonds which do not have a ceiling. In Illinois, the city of Chicago has found the interest rate ceilings particularly disruptive. Until recently, the 6 per cent limit was suspended until July 1, 1971, and during this period the City can try to sell issues at 7 per cent. Even so, Chicago is reported to be having considerable difficulty selling its obligations to the banks. The Chicago school system has been hit particularly hard.

About half of the States which now have ceilings of 7 per cent or more on general obligations only recently raised their limits to this level. Included in this group are Michigan, Missouri, Oregon and Pennsylvania. Moreover, Michigan and Pennsylvania have only temporary authorization for the higher ceilings. Undoubtedly, some borrowers which do not have high-grade ratings find it difficult to borrow even at these limits -- unless they are willing to limit themselves to relatively short maturities. For instance, it was reported that local governments in Kentucky are having trouble selling bonds at 7 per cent and are relying heavily on one-year bond anticipation notes.

Finally, for a number of State and local governments with no official ceilings, the situation is not as firm as it may seem. For example, in both New York and New Jersey, the ceiling was suspended for about one year, and by mid-1970 the ceilings are scheduled to return to the previous levels of 5 per cent and 6 per cent, respectively. Moreover, in some States which may or may not have official ceilings, the State usury laws ordinarily apply. Thus, in some cases even where no specific ceiling is set, there actually may be an effective legal limit to interest rates that can be paid on municipals. Consequently, if market yields were to continue to rise as they did over the last year, a fairly large number of States would have to rewrite their usury laws as well.

Before closing this part of the discussion, we should pause briefly to take note of the State of Maryland's experience -- although the facts are widely known. It will be recalled that until last December the ceiling on the State's general obligations was 5 per cent. However, since its issues were rated Aaa, Maryland had experienced no difficulty in selling bonds until it attempted to market $40 million of construction bonds in late November of last year. At that time, high-grade municipal bond yields were rapidly approaching 6-1/2 per cent. Maryland was faced with the alternatives of halting construction, borrowing from the current operating surplus (a short-run solution at best), or changing the ceiling. As it happened, a special session of the legislature was called which -- among other actions -- removed the 5 per cent ceiling altogether. But before that action could be taken, the State had to face an extremely difficult situation -- and (as mentioned below) some of the temporary moves which were made in the interval are prime examples of the real burdens imposed by interest rate ceilings.

The conclusions which can be drawn with respect to the structure and impact of statutory interest rate ceilings on State and local government debt can be stated succinctly: while the existence of ceilings remains rather widespread, a large number of States raised or suspended such limitations during the last year or are now considering such increases. In fact, in some cases, States which lifted their rate ceilings last year may well have to do so again if bond flotations remain heavy. With the exception of California (which must submit a proposed rate change to the voters in a general election), every major borrower raised or suspended ceilings last year. If they had not taken these steps, they would have been unable to sell bonds under the market conditions prevailing during most of the last twelve months -- and many of them (especially California) are still encountering obstacles.

### Decline in Commercial Banks' Demand for State and Local Government Debt

As is widely known, the commercial banks have traditionally provided the principal outlet for municipal issues. This strong demand undoubtedly reflected the advantage of tax-exempt income to the banks. In addition, however, many banks also seemed to have accepted an obligation to assist their own State and local governments with their financing problems, and this willingness to assist was frequently enhanced by the deposit of public funds. But in 1969, a conjuncture of adverse circumstances -- including reduced bank resources, low interest rate ceilings, and uncertainties over Federal income tax reform -- brought about a sharp decline in commercial banks' participation in the municipal bond market.

Last year, net purchases of State and local government issues by commercial banks amounted to only $1.2 billion -- in contrast to $8.7 billion in 1968 and $9.0 billion in 1967. The decline was even more dramatic when the changes in commercial banks' holdings are compared with the net funds raised by these governments. Last year, the banks' share represented only 14 per cent of the total. In 1967, the banks expanded their holdings by an amount greater than the total rise in liabilities of State and local governments: the total rose by $7.7 billion and bank holdings by $9.0 billion. In 1968, the banks absorbed nearly 90 per cent of the total increase.

Of course, as indicated above, some part of the commercial banks' lessened demand for municipal issues can be attributed to the generally reduced availability of credit at these institutions last year. But this is by no means the entire story. There certainly was a sharp decline in 1969 in the volume of funds advanced by commercial banks to all borrowers. Last year, this total was about $9.6 billion, compared with $39.3 billion in 1968 and $36.5 billion in 1967. Even so, State and local governments got a substantially reduced share in 1969 -- only 12-1/2 per cent of the total, compared with 25 per cent in 1967 and 22 per cent in 1968.

As I stressed above, I believe a good part of the lessened taste of commercial banks for municipal obligations reflects the adverse effects of the low limits on interest rates which many State and local jurisdictions can pay. To test this conclusion, we have made a special analysis of the year-to-year changes in State and local government securities held by weekly reporting member banks in a dozen States during the three years 1966-1969. For the most part, these States (on the average) have been the leading borrowers through the issuance of long-term securities over the last five years. The details of the analysis are shown in Tables 2 and 3, attached.

Among the twelve States, there were four (California, Maryland, New York and North Carolina) which had interest rate ceilings of 5 per cent or less on general obligations through much of 1969. As indicated in Table 2, the actual holdings of State and local securities by banks in these four States declined from the end of 1968 to the end of 1969. The average decline for this group was about 10 per cent. For all weekly reporting member banks, holdings of municipal obligations also declined -- but by only 7 per cent. Banks in all of the other States shown (except those in Pennsylvania) recorded moderate increases over this period. The decline in holdings by Pennsylvania banks may be explained by the fact that the rating of Philadelphia bonds was reduced sharply by private rating agencies in late 1967,

Table 3 shows ratios of member banks' holdings of State and local obligations to total securities held. Again, it is clear that banks in those States subject to low interest rate ceilings have adjusted their investments in a way that is in sharp contrast to the experience of banks in States not under interest rate limitations. In general, the ratio of State and local obligations to total securities has been rising for all banks from the end of 1966 to the end of 1969. However, from the end of 1968 to the end of 1969, the increase in the ratio at banks in States not subject to low interest rate limitations has been much greater than in those States where such interest rate limitations apply. In fact, the ratio for this latter group has been about unchanged. For example, the change in this ratio for banks in the four States which were subject to a 5 per cent interest rate limitation ranged from -2.2 to 2.9 with a mean of 0.5 from the end of 1968 to the end of 1969. The range in this ratio for banks in those States, in our sample, not subject to such limitations was 3.4 to 7.9 with a mean of 6.1, or more than ten times greater than the ratio for the low interest rate States. (This comparison excludes banks in Pennsylvania for the reasons stated above. However, inclusion of these data would not change the result significantly.)

It is hazardous to infer too much from these data since the number of banks reporting from each State varies appreciably. Nevertheless, the pattern seems too closely correlated not to reflect some common portfolio adjustment by banks in States where low interest rate limitations are in effect.

All of the rough calculations presented above show banks in States with low interest rate ceilings holding relatively fewer State and local obligations than do banks in States where no such constraint exists. In addition, it can be inferred from the data that the market for State and local obligations, at least so far as the banking system is concerned, is segmented, and in large part such securities are not readily traded on an interstate basis. If these securities were more easily traded, one would expect to see more uniform movement in the portfolio adjustments of banks as the obligations of some States come under interest rate contraints. That is, banks in States with low interest rate ceilings would substitute obligations from their home State for the securities of States with higher rates. On the basis of the data available, such substitution does not appear to take place in a significant volume.

The holdings of State and local securities by banks located in the State of Maryland appear to follow the general pattern of banks located in States with low interest rate ceilings. (The change in the Maryland law came too late in the year to have much effect on the holdings of banks in the State.) Holdings of such securities by Maryland banks declined almost 11 per cent from the end of 1968 to the end of 1969, about in line with the experience of other banks in States where low interest rate ceilings were in effect. The ratios of State and local securities to total securities at Maryland banks reinforces the above pattern. This ratio was about unchanged from the end of 1968 to the end of 1969, increasing only 0.6 per cent, compared to the average increase of 6.1 for banks in States with higher interest rate ceilings.

In summary, the data for weekly reporting member banks show that from the end of 1968 to the end of 1969 large banks seem to have followed a consistent pattern of reducing the importance of State and local obligations in their portfolios. The data also show that at banks in States where interest rate ceilings permitted on general obligation securities are out of line with market rates of interest the portfolio adjustment was much more drastic than in those States where such ceilings did not apply.

Market Displacements and the Search for Alternative Sources of Funds

With the traditional commercial bank market for State and local government issues falling away, these jurisdictions have been forced to search vigorously for other means of adjusting to stringent capital market conditions. In many instances, these alternatives have been unwieldy and often more expensive than public market borrowing based on the full faith and credit of the issuing agency.

In the first place, though, many would-be borrowers simply had to stand aside from the market at the time they originally planned to sell bonds. A rough indication of the extent of this interruption in plans is given by the volume of displacements as reported by the Bond Buyer. In this series, displacements include issues which were postponed, on which no bid was received, or on which all bids were rejected. At the beginning of January, 1970, the cumulative total of municipal displacements (cumulative from September 3, 1968, when the series was started) was $2,836 million. Although this is a large backlog of displacements, one should be cautious in interpreting its meaning, since it probably underestimates the actual volume of issues put aside -- at least temporarily. Moreover, the series cannot capture those issues which were never initiated because local officials knew it would be useless and costly to advertise bonds, given the prevailing level of yields.

State and local officials -- faced with restricted access to the long-term capital markets because of ceilings on general obligations -- have relied more heavily on revenue bonds, short-term borrowing, increased taxes or curtailment of expenditures. In 1969, a substantial number of government units resorted to one or more of these measures. Revenue bonds or issues of special authorities often have more liberal interest rate ceilings than those on State general obligation bonds. Therefore, a number of governments use special building authorities which can issue revenue bonds and then lease the facilities back to the school or library official which cannot market their own bonds. This is not a new device, of course, but it is reported that a number of jurisdictions (particularly school districts) relied on such special authorities much more frequently in 1969.

Short-term borrowing by State and local governments increased sharply last year. Preliminary estimates suggest that the total may have reached about $11.9 billion, a rise of $3.2 billion over the amount recorded in 1968. At this level, short-term borrowing would represent more than half of the $23.4 billion of total new issues offered in 1969. This was a record proportion by a large margin. The 1968 share of short-term issues in the total (just over one-third) was about the average for the decade of the 1960's. In many cases, however, there are legal limitations on refunding short-term obligations, so this means can provide only a temporary solution to the financing problems of most units.

A number of State and local governments have also found it necessary to take special steps (or to engage in special persuasion) to induce buyers -- particularly commercial banks -- to purchase newly issued obligations. A good example of this is reported from Chicago. The leading banks in that city agreed to take $45 million of a proposed $145 million tax anticipation borrowing after the State of

Illinois agreed to place $15 million in non-interest bearing deposits with those banks. Another example of banks' response to special appeals is found in the State of Maryland. Late last year, when difficulties in selling bonds arose because of the then existing 5 per cent rate ceiling, the State Treasurer negotiated with six large Maryland banks and obtained commitments from them to lend $12 million to the State for a few months until the Legislature could act at its regular session in February. The banks agreed to lend the money at 5 per cent, well below the prime rate. In passing, it should be noted that at least some of these banks held a sizable amount of public deposits -- which undoubtedly was a factor in their consideration of the appeal to participate in the loan pool for the State.

Still other examples of the alternatives on which State and local governments have depended to raise funds could be cited. However, they all tell the same story: low interest rate ceilings greatly limited the access of many of these units to the capital market in the last year of sharply rising market yields.

Effects on State and Local Government Expenditures

Because we have only incomplete data on capital outlays by State and local units, it is difficult to assess the impact of these borrowing problems on their level of spending. Surveys conducted by the Federal Reserve System in 1966 (a year in which long-term borrowings by these governments were $1.4 billion lower than original plans) did not show a significant decline in capital spending as a result of the reduced availability of credit. However, there was no long period of ready availability of funds between the credit stringency of 1966 and the end of 1968 which would have permitted these governments time to build up their liquid assets and increase the borrowing flexibility. Moreover, the short-fall between planned and actual long-term borrowing in 1969 was undoubtedly much greater than the $1.4 billion estimated for 1966. While we have no direct measure of this gap for last year, the decline of over $4 billion in long-term bond sales in 1969 compared with the volume in the previous year certainly does suggest that it was quite large.

Therefore, it is expected that the impact on construction spending in 1969 was more severe than in the earlier period. The latest State and local government construction figures available (for the third quarter of 1969) suggest that an adverse impact of reduced municipal long-term borrowing was already appearing by the end of last summer. In the twelve months ending last September, State and local outlays for new construction rose by 7 per cent; in the same period a year earlier, the rise was close to 9 per cent. Moreover, in the most recent period, expenditures on educational facilities showed no change, whereas in the previous year such outlays rose by 3 per cent.

Local governments, which finance almost two-thirds of their capital outlays by means of long-term borrowing, will probably be affected more severely in this respect than State governments, which rely on long-term bonds to finance about half of their construction expenditures. Given the present emphasis on control of the Federal budget, it is unlikely that Federal grants to the States and subdivisions will expand enough to take up the slack.

Thus, if these governmental units are to find relief -- and if their capital investment is not to be hampered continuously -- they must have greater access to the capital markets. Removal of low interest rate ceilings on their debt is one necessary step in the right direction.

## Outlook for State and Local Government Borrowing

Trying to assess the outlook for State and local governments in the capital market is obviously very difficult. Furthermore, this difficulty is compounded by the need on my part to avoid making any suggestion about the probable future course of monetary policy. Nevertheless, a number of elements underlying such an outlook can be marshalled.

In 1969, long-term offerings of securities by State and local governments averaged between $800 million and $900 million per month, and the monthly average was smaller in the second half than it was in the first half of the year. In January, it is estimated that the volume was about $1.3 billion. The sale of these issues was facilitated by a decline in municipal yields through mid-month, and the lower interest rates also induced the reoffering of several issues previously postponed. The improved market conditions in the first part of January were in turn helped by a strengthened dealer inventory position, and a large percentage of the January offerings was of a high quality with shorter-term maturities. In recent weeks, however, the calendar of anticipated long-term financing has built up to a sizable volume, while purchases have been concentrated relatively more on shorter maturities. The result has been a rebound in long-term tax-exempt yields.

Given the steadily expanding backlog of displacements and the continued buildup in the forward calendar, the volume of municipal flotations may remain very large for a number of months. Over the longer run, the need to finance a high -- and even rising -- level of capital formation in State and local jurisdictions will almost certainly become more -- rather than less -- pressing.

Against this prospect, it would seem impractical for public officials to put off the removal of outdated interest rate ceilings in the hope that market rates will soon decline to levels comfortably within present ceilings. In addition to the expected volume of newly generated issues, the supply of municipal securities has been artificially suppressed, and is potentially anywhere from the $2.8 billion recorded in the Bond Buyer's displacement series to the estimated $4 - $5 billion shortfall in planned borrowings in 1969. Certainly no one would argue that the need for schools, housing, utilities, transportation, and other public facilities will be any less.

In the meantime, the major element of uncertainty in the interest rate picture is the demand for tax-exempt securities. The reduced purchases by commercial banks and the challenge to the tax-exempt market among individuals which was raised by tax reform legislation last year both depressed demand for municipal securities so much that even the sharp fall in volume in 1969 could only be absorbed at the cost of sharply rising market yields.

Individual buying will undoubtedly pick up again if there are no further moves by Congress to eliminate the tax exemption privilege. Commercial bank purchases obviously will depend on general credit market conditions, but it would seem unlikely that there would be sufficient demand by banks to absorb the potential supply which would come to market if municipal rates were to ease significantly. This implies that, even if municipal yields decline somewhat from their present high levels, they probably will not return to pre-1966 levels in the near future. While flow of funds data suggest that corporations increased their holdings of municipals substantially during 1969, it appears that most of their purchases were of short-term securities. Thus, it would be extremely unwise for State and local governments to count on these firms as a lasting outlet for their obligations.

Instead, they should really set to work trying to improve their access to the long-term capital market. While this effort must go forward on a number of fronts, the removal of outdated statutory limits on the interest rates they can pay on long-term debt is a necessary move -- which ought to be made without further delay.

Table 1. Statutory Interest Rate Ceilings on State and Local Government Securities, by State and Type of Obligation, January, 1970

| Area and Level of Ceiling | State Governments: General Obligations | State Governments: Revenue Bonds | State Governments: State Agency | Local Governments: General Obligations | Local Governments: Revenue Bonds | Local Governments: Local Agency | Comments |
|---|---|---|---|---|---|---|---|
| <u>Under 6 per cent</u> (On General Obligations ) | | | | | | | |
| Arizona | 5 | 5 | 5 | 6 | 6 | None | |
| Arkansas | Varies | Not issued | Varies | 6 | 6 | 6 | State: Usually 5 per cent. |
| California | 5 | Varies | 5 | 5 | Varies | 7 | State: Some agencies have 7 per cent ceiling. |
| Kansas | 5-1/2 | 6 | 5-1/2 | 5-1/2 | 6 | 5-1/2 | |
| Montana | 5-1/2 | 5-1/2 | 6 | 6 | 6 | 6 | |
| <u>Between 6 and 7 per cent</u> (On General Obligations) | | | | | | | |
| Alabama | 6 | 6 | Varies | None | None | None | Local: 8 per cent usury limit applies. |
| Birmingham | | | | 6-1/2 | None | Varies | |
| Alaska | 6 | 6 | 6 | None | None | None | |
| Hawaii | 6 | None | Not auth. | 7 | 6 | Not auth. | |
| Illinois | 6 | 6 | 6 | 6 | 6 | 6 | |
| Chicago | | | | 7 | None | None | Local: Chicago limit suspended until July 1, 1971 |
| Iowa | 6 | 7 | Not issued | 7 | 7 | 6 | |
| Kentucky | 6-1/2 | 6-1/2 | 6-1/2 | 7 | 7 | 7 | |

| | State Governments | | | Local Governments | | | |
|---|---|---|---|---|---|---|---|
| | General Obligations | Revenue Bonds | State Agency | General Obligations | Revenue Bonds | Local Agency | Comments |
| Between 6 and 7 per cent (On General Obligations) (continued) | | | | | | | |
| Mississippi | 6 | 6 | 6 | 6 | 6 | 6 | |
| New Mexico | 6 | 4 | 6 | 6 | None | 6 | |
| North Dakota | Not issued | 6-1/2 | Not issued | 6 | 6 | Not auth. | |
| Oklahoma | 6 | 5 | Varies | 6 | Not auth. | None | |
| Utah | 6 | 6 | 6 | None | None | None | |
| Virginia | 6 | 6 | 6 | 6 | 6 | 6 | |
| 7 per cent and over (On General Obligations) | | | | | | | |
| Colorado | 7 | None | None | 6 | 6 | 6 | |
| Florida | 7 | 7 | 7 | 7-1/2 | 7-1/2 | 7-1/2 | |
| Michigan | 8 | 8 | 8 | 8 | 8 | 8 | |
| Missouri | 8 | 8 | 8 | 8 | 8 | 8 | |
| Nevada | 7 | Not issued | 7 | 7 | 7 | 7 | |
| Oregon | 7 | Not issued | Not issued | 7 | 7 | 7 | |
| Portland | | | | 6 | Not issued | Not issued | Local: Portland ceiling in City Charter. |
| Pennsylvania | 7 | 7 | 7 | 7 | 7 | 7 | From 6 during July 1, 1969 to July 1, 1970 |
| Philadelphia | | | | None | None | None | Exception: 6 on port, transit and street bonds. |

| | State Governments | | | Local Governments | | | |
|---|---|---|---|---|---|---|---|
| | General Obligations | Revenue Bonds | State Agency | General Obligations | Revenue Bonds | Local Agency | Comments |
| 7 per cent and over (cont'd) | | | | | | | |
| South Carolina | 7 | 7 | 7 | 7 | 7 | 7 | |
| Tennessee | 10 | 10 | 10 | 10 | 10 | 10 | |
| No ceilings (On General Obligations) | | | | | | | |
| Connecticut | None | None | None | None | None | Not issued | |
| Delaware | None | 6 | 6 | 6 | 6 | 6 | |
| Georgia | None | None | None | None | 7 | 7 | |
| Idaho | None | None | None | None | None | None | |
| Indiana | None | None | None | None | None | None | |
| Louisiana | None | None | None | None | None | None | |
| New Orleans | | | | None | 6 | 6 | |
| Maine | None | None | None | None | None | Varies | |
| Maryland | None | None | None | None | None | None | |
| Massachusetts | None | None | None | None | None | None | |
| Minnesota | None | None | None | None | None | None | |
| Nebraska | None | None | None | None | None | None | Local: 9 per cent usury limit applies. |
| New Hampshire | None | None | None | None | None | None | |
| New Jersey | None | None | None | None | None | None | Limit suspended, July 1, 1969 to June 30, 1970 |

| | State Governments | | | Local Governments | | | |
|---|---|---|---|---|---|---|---|
| | General Obligations | Revenue Bonds | State Agency | General Obligations | Revenue Bonds | Local Agency | Comments |
| No ceilings (cont'd) (On General Obligations) | | | | | | | |
| New York | None | None | None | None | None | None | Limit suspended, April 15, 1969 to April 15, 1970. |
| North Carolina | None | None | None | None | None | None | |
| Ohio | None | None | None | 8 | 8 | 8 | |
| Rhode Island | None | None | None | 6 | Not auth. | 6 | |
| South Dakota | None | Not issued | 6 | 6 | Not issued | 6 | |
| Texas | None | None | None | None | None | None | Local: 10 per cent usury limit applies. |
| Vermont | None | None | None | 6 | 6 | Not issued | |
| Washington | None | None | None | 8 | 8 | 8 | |
| West Virginia | None | 6 | 6 | 6 | 6 | 6 | |
| Wisconsin | None | None | None | 8 | 8 | 8 | |
| Wyoming | None | None | None | None | None | None | |

Table 2. State and Local Government Securities Held by
Weekly Reporting Member Banks in Selected States
(Amounts in millions of dollars)

| Seclected Dates | Calif.1/ | Mary-land1/ | New York1/ | North Carolina1/ | Fla. | Illinois | Mich-igan | New Jersey | Ohio | Pa.2/ | Texas | Va. | All Weekly Reporters |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| December 28, 1966 | 3,759 | 183 | 6,571 | 433 | 217 | 1,590 | 1,265 | 584 | 1,473 | 1,342 | 907 | 297 | 23,410 |
| December 27, 1967 | 4,740 | 284 | 8,202 | 511 | 221 | 1,673 | 1,563 | 728 | 1,930 | 1,950 | 1,043 | 362 | 29,407 |
| December 31, 1968 | 5,376 | 280 | 9,448 | 620 | 310 | 2,111 | 1,821 | 825 | 2,127 | 2,434 | 1,286 | 424 | 34,500 |
| December 31, 1969 | 4,880 | 250 | 8,319 | 560 | 315 | 2,153 | 1,901 | 856 | 2,134 | 2,087 | 1,206 | 428 | 31,974 |
| Changes: (per cent) | | | | | | | | | | | | | |
| 1966 - 1967 | 26.1 | 55.2 | 24.8 | 18.0 | 1.8 | 5.2 | 23.6 | 24.7 | 31.0 | 45.3 | 15.0 | 21.9 | 25.6 |
| 1967 - 1968 | 13.4 | -1.4 | 15.2 | 10.7 | 40.3 | 26.2 | 16.5 | 13.3 | 10.2 | 24.8 | 23.3 | 17.1 | 17.3 |
| 1968 - 1969 | -9.2 | -10.7 | -11.9 | -9.7 | 1.6 | 2.0 | 4.4 | 3.8 | 0.3 | -14.3 | 1.5 | 0.9 | -7.3 |

(1) States with interest rate ceilings of 5 per cent or less on general obligations through most of 1969.

(2) The rating of Philadelphia bonds was reduced sharply by private rating agencies in late 1968, and this may have had an adverse effect on bank holdings of these securities.

Table 3. Ratio of State and Local Government to Total Securities Held by Weekly Reporting Member Banks in Selected States (Per cent)

| Selected Dates | Calif.1/ | Mary-land1/ | New York1/ | North Carolina1/ | Fla. | Ill. | Mich-igan | New Jersey | Ohio | Pa.2/ | Texas | Va. | All Weekly Reporters |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| December 28, 1966 | 44.9 | 40.9 | 48.0 | 55.5 | 39.8 | 44.6 | 43.1 | 53.0 | 46.2 | 47.7 | 43.8 | 50.3 | 45.5 |
| December 27, 1967 | 51.3 | 49.9 | 50.5 | 56.5 | 35.4 | 41.4 | 45.4 | 55.3 | 48.0 | 51.3 | 44.6 | 51.3 | 47.6 |
| December 31, 1968 | 49.6 | 48.4 | 52.7 | 59.9 | 43.8 | 44.6 | 46.4 | 54.7 | 51.4 | 57.9 | 47.6 | 54.6 | 50.5 |
| December 31, 1969 | 52.5 | 49.0 | 53.4 | 57.7 | 51.7 | 50.2 | 52.6 | 61.1 | 57.3 | 59.8 | 55.0 | 58.0 | 53.6 |
| Changes in Ratio (Percentage Points) | | | | | | | | | | | | | |
| 1966 - 1967 | 6.4 | 9.0 | 2.5 | 1.0 | -4.4 | -3.2 | 2.3 | 2.3 | 1.8 | 3.6 | 0.8 | 1.0 | 2.1 |
| 1967 - 1968 | -1.7 | -1.5 | 2.5 | 3.4 | 8.4 | 3.2 | 1.0 | -0.6 | 3.4 | 6.6 | 3.0 | -3.3 | 2.9 |
| 1968 - 1969 | 2.9 | 0.6 | 0.7 | -2.2 | 7.9 | 5.6 | 6.2 | 6.4 | 5.9 | 1.9 | 7.4 | 3.4 | 3.1 |

1/ Same as Table 2.
2/ Same as Table 2.

CHAIRMAN BURNS

For Information Only

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

# Office Correspondence

**Date** March 18, 1970.

**To** Board of Governors

**From** Governor Brimmer AFB

**Subject:** Processing of foreign banking applications.

For Information Only

This memorandum is by way of a brief report on the efforts being made to improve and expedite the processing of applications submitted to the Board in the foreign banking area.

As a first step in this effort, a meeting was held recently between members of the Board's staff and staff members of the New York Reserve Bank to identify the reasons for and the points at which delays have occurred in the processing of applications. During that meeting, an extensive review was conducted of Reserve Bank problems associated with deficient applications, internal clearances with the Legal Department and others, and procedures followed in processing different classes of applications.

As an outgrowth of that meeting and subsequent discussions, the staff has developed an information checklist indicating the types of information applications in this area will be expected to contain if they are to be accepted as filed within the System. Too large a number have been submitted where the Reserve Bank has had to request additional information before being in a position to comment on and provide recommendations on the applications. Meanwhile, the application has been considered as filed with the System. The information checklist and the requirement that adequate information be furnished before the application is considered as filed should help to avoid these situations in the future.

A further result was to review the procedures to be followed at the Reserve Banks in processing these applications and forwarding them to the Board. A revised and stricter set of guidelines to be followed by the Reserve Banks has been developed.

The information checklist and the revised procedural guidelines have now been distributed to all the Reserve Banks, under cover of a letter from Mr. Solomon addressed to the Vice Presidents in Charge of Examinations. Copies of this material are attached for the information of Board members.

These measures were foreseen in Mr. Solomon's memorandum to the Board dated January 22, 1970. Others are in process. At the Federal Reserve Bank of New York, measures have been taken to simplify and expedite the clearances of applications with the bank's Legal Department. Here at the Board an internal reporting program on the status of applications in this area is now fully operative, enabling a better guide of processing performance. Additional manpower has been obtained on a temporary basis and further efforts to recruit a permanent addition to this function are continuing.

Attachments.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

SR-61

DIVISION OF SUPERVISION
AND REGULATION

March 18, 1970.

TO THE VICE PRESIDENTS IN CHARGE OF EXAMINATIONS
AT ALL FEDERAL RESERVE BANKS

Dear Sir:

As you know, the Board has for some time been concerned with the processing time required in connection with applications dealing with foreign banking matters and filed under Regulations K and M. A further review has been conducted of the processing procedures followed at the Board and within the System as a whole. The purpose of this review has been to examine again whether improvements might be made to facilitate and expedite the processing of these applications. As part of this effort, procedures at the Board are being streamlined and consideration is being given to further delegations of the Board's authority to approve such applications.

As a further part of this effort, a checklist has been developed of the types of information which applications filed under these Regulations are expected to contain. A copy of the checklist is enclosed. This checklist is being made available to all Reserve Banks for further distribution to applicants (present and future) under these Regulations. As noted in the instructions to the checklist, applications which do not reasonably fulfill the specified information requirements are not to be considered as filed until the lacking information is furnished. It is hoped that this procedure will relieve applicants of uncertainty about the information required in these applications and will also relieve the Reserve Banks from the possible necessity of repeatedly going back to applicants for additional information in the preparation of the Reserve Banks' own memoranda and recommendations to the Board on the applications.

Also enclosed with this letter is a set of guidelines on the procedures to be followed at the Reserve Banks in accepting and processing applications under these Regulations. It is believed that these guidelines will help simplify the processing of these applications without detracting from due consideration being given to those applications involving questions of law and regulatory policy.

Frederic Solomon

Frederic Solomon,
Director.

# Guideline Procedures for Processing Applications under Regulations K and M

(1) Review all applications for sufficiency of information in accordance with the checklist.

a. If information is sufficient, forward applications to the Board and process in accordance with the procedures described below.

b. If information is not sufficient, inform the applicant in what respects the application is deficient and that the application will not be considered as filed until such necessary additional information is furnished. If necessary, return the application for resubmission by applicant. Deficient applications need not be forwarded to the Board, but Reserve Banks are to inform the Board by letter of any applications received that have been determined as "not filed."

(2) Determine whether the filed applications are of a routine or nonroutine nature. In most cases, applications of a routine nature would include: amendments to Articles of Association of Corporations; borrowing authority under Section 211.4 of Regulation K; additional investments in companies in which stock is already held and the investment will not result in control or otherwise significantly alter the ownership interest of the applicant; new investments that would qualify under the General Consent provisions of Regulation K except for the dollar amount limitation; and minor investments such as nominee companies.

(3) Recommendations regarding routine applications should be contained in the letters transmitting such applications to the Board. No separate memorandum or analysis is required. Such applications should be transmitted to the Board within two or three days after receipt.

(4) Applications of a nonroutine nature should immediately be forwarded to the Board. Subsequently, the Reserve Bank should prepare a memorandum which should include at the outset a summary of the issues involved, followed by a discussion that contains: (a) a summary of the proposal and the reasons therefor; (b) an analysis of any issues of law and regulatory policy involved; (c) an assessment of the condition of the applicant; (d) in the case of applications for a bank's first foreign branch or Corporation, information on the applicant's foreign business, its character and size, and on the background and experience in international operations of officers involved in the proposed activity; (e) anticompetitive effects, if any; (f) a synopsis of experience with the applicant under the Foreign Credit Restraint Program and the current position under the Program; (g) recommendations of the Reserve Bank as to whether or not the application should be approved.

(5) Reserve Bank memoranda and recommendations on nonroutine applications should be forwarded to the Board within two weeks following receipt of the application. If that time schedule cannot be met, please inform the Board as early as possible, indicating the reasons for the need for additional time and the date by which the material will be forwarded. Only in very exceptional circumstances should the time for Reserve Bank processing of applications exceed four weeks.

## APPLICATIONS SUBMITTED TO THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

## UNDER REGULATIONS K AND M

The following material has been prepared to assist member banks and Edge and Agreement Corporations in the preparation and filing of applications relating to international operations under the Board's Regulations K and M. Checklists are provided of the types of information that will normally be expected to be furnished in applications for establishment of foreign branches, establishment of Edge Corporations, and investments in stocks. In certain instances, some of the items indicated may not be applicable. However, applications, which in the judgment of the Reserve Bank do not contain substantially the types of information specified in the checklists, will not be considered as filed and may be returned to the applicant for resubmission. In the event of questions, consultations with the Reserve Bank are advised.

Applications should be addressed to the Board of Governors of the Federal Reserve System and are to be submitted, in duplicate, through the Federal Reserve Bank of the District in which the member bank or Corporation is located. Applications may be in letter form, or by letter accompanied by memoranda containing details of the proposed establishment or investment. The latter may be more convenient where supplemental information is being furnished to assist in the Board's consideration of the application.

In general, prior consultations with the Reserve Bank or, if necessary, the Board's staff are suggested in the case of the proposed establishment of Edge Corporations and of proposed investments with unusual characteristics. The consultations can help assure that applications are properly filed and facilitate processing when filed.

## INFORMATION CHECKLIST

Foreign Branches: Initial branch in a foreign country.

1. Name and capital of applying member bank.
2. Location (city and country) of proposed branch, including address (if decided upon).
3. Reasons for the proposed branch, including the ways in which it is believed the branch would further the development of the applying bank's international or foreign business.
4. Type of business to be conducted and types of services to be offered by the proposed branch.
5. Details as to the competitive situation in the foreign country.
6. Management of the proposed branch.
7. Estimated start-up costs, and projections of income, expenses, and profitability.
8. Foreign government approvals, if any. (In the case of State member banks, status of any State approval required.)
9. In the case of member banks applying for their first overseas branch, a summary of the bank's experience in international banking operations, including the volume and character of the bank's present international business, and a description of the bank's foreign or international department, the number of its staff, and background of its officers, unless such information has been previously furnished in connection with the establishment of an Edge Corporation, or otherwise.

10. Status of applying bank under the Foreign Credit Restraint Program, and ability of bank to establish the branch within the guidelines of the Program.



Additional branches in a country.

As provided in Regulation M, member banks may upon 30 days' notice to the Board establish additional branches in a foreign country in which they already operate a branch. Notification of intent to establish such branch is to be made by letter, which is to specify the city in which the branch is to be located (also the address, if decided upon), the status of any government approvals required, and any investment to be made by the applying bank in the additional branch.

Edge Corporations.

1. The proposed articles of association and an executed organization certificate, as prescribed by Section 25(a) of the Federal Reserve Act and Section 211.3(a) (including footnote) of Regulation K.
2. Purposes for which the Corporation is to be established and the activities contemplated for the Corporation.
3. In the case of a member bank seeking for the first time to establish a Corporation, a summary of the bank's experience in international banking operations, including the volume and character of the bank's present international business; a description of the bank's foreign or international department, the number of its staff, and background of its officers, unless such information has been previously furnished in connection with a foreign branch, or otherwise.

4. Management of proposed Corporation, including a short biographical sketch of each of the proposed directors and officers.
5. Any other information that may help in processing the application.

Investments in shares.

1. Proposed investment.
   a. Name and location of company.
   b. Number and type of shares to be acquired.
   c. Par value.
   d. Percentage of total number of shares outstanding.
   e. Cost in local currency and in U.S. dollars (showing exchange rate used). Amount of premium being paid, if any, and basis for computation. (Board approvals of acquisitions of subsidiaries require a write-off of any excess paid over the net tangible asset value of the shares acquired.)
2. Description of company in which investment is proposed.
   a. Type of business.
   b. Historical background.
   c. Ownership of company: list all shareholders holding 10 per cent or more of any class of stock of the company, the amount or per cent of stock held by each such shareholder, and appropriate comments on such shareholders and their relationship to the company.

Investments in shares. (continued)

2. d. List of directors and senior officers of company or bank in which the investment is to be made, with the addresses and principal affiliations of each.

   e. List offices, subsidiaries, and affiliates, and provide information on the activities conducted by each.

   f. Details of any business conducted, directly or indirectly, by the company in the United States.

3. Financial and related information.

   a. Latest available balance sheet and income statement, with an explanation of any unusual items.

   b. Listing of all equity holdings, including percentage of shares held.

   c. Capital stock. Number and classes of shares outstanding, and the rights and privileges of each class of stock. (If proposed investment is in shares of a limited liability partnership, furnish details as to liabilities of such shares.)

4. Purpose of investment and relationship of applicant to company.

   a. Describe objectives or indicate reasons for making the proposed investment.

   b. Indicate extent to which credit or other services are presently extended to company in which investment is proposed. Also, other existing relationships with company or its principal shareholders.



   c. Provide details on relationship with company after investment is made, including degree of representation on Board of

Investment in shares. (continued)

c. Directors and participation in management. Indicate whether applicant will control the company or where effective control will lie.

d. Details on any loan or credit transaction to be entered into in connection with proposed investment or subsequent thereto.

5. Miscellaneous.

a. Articles of association and by-laws of company in which investment is to be made, if available.

b. Information as to whether or not approval of foreign government agencies is necessary and, if so, the status of such approval.

c. Status of applicant under Foreign Credit Restraint Program and ability to make the investment with the guidelines of the Program.

d. Any other information that may help in processing the application.

For Release in AM'S
Sunday, March 22, 1970

# ECONOMIC PROGRESS OF NEGROES IN THE UNITED STATES

## The Deepening Schism

Remarks by

Andrew F. Brimmer
Member
Board of Governors of the
Federal Reserve System

At the

Founders' Day Convocation

Tuskegee Institute
Tuskegee, Alabama

March 22, 1970

# ECONOMIC PROGRESS OF NEGROES IN THE UNITED STATES

## The Deepening Schism

By
Andrew F. Brimmer*

To be asked to address this Founder's Day Celebration in honor of the memory of Booker T. Washington is really a way of honoring the one receiving the invitation. Not only on this campus, or in this community, but in the country at large anyone with even the most modest sense of history knows that the memory of Booker T. Washington is honored every day by the simple fact that Tuskegee Institute is here. That memory is embossed and embellished each time that this institution can render another day of service to the Negro community, to its region and to the nation through its commitment to higher education.

Yet, it is also good to pause at least once each year to reflect explicitly on the founding of this institution in rural Alabama in 1881. Since 1917, Tuskegee has found the time for such reflection, and the roster of speakers testifies to the high regard for Tuskegee in this country and in the world. This annual celebration has drawn to this campus a President of the United States, the Head of a foreign government, a Chief Justice of the Supreme Court, members of the President's Cabinet, other leading representatives of the Federal and State governments -- as well as eminent scholars and educators and

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* Member, Board of Governors of the Federal Reserve System.
I am grateful to Mr. Henry S. Terrell and Miss Harriett Harper of the Board's staff for assistance in the preparation of these remarks.

outstanding figures in the private sector. However, in coming here, they came as much to encourage the work of a growing Tuskegee as to honor the memory of its founder. So I am flattered to be a part of this tradition.

Having accepted the invitation to speak before this assembly, I decided that you really did not want me to dwell on the obstacles which Booker T. Washington had to overcome in the creation of a viable institution; nor did you expect me simply to extol the record of Tuskegee's achievements during the last 89 years. Rather, given the nature of my own responsibilities, I assumed that I was invited because you thought I might have something to say with a bearing on some of the central economic issues which we face today -- especially those issues of immediate relevance to the Negro community.

On that assumption, I decided that it might be helpful to focus on a question that has generated a considerable amount of debate in the last few weeks: did Negroes make such extraordinary progress during the 1960's that the best course for public policy over the years ahead is one of "benign neglect"? Obviously this is not a trivial question. While the exact meaning of this proposition is far from clear, it has been advanced in a context whose potential impact on public policy in the area of race relations can be considerable. Thus, it is crucial that all of us have a clear understanding of the extent of economic progress which Negroes have made -- and we must also have a full appreciation of the extent to which important segments within the Negro community have failed to share in this progress.

To help provide such an understanding, I have pulled together a considerable amount of statistical information relating to the economic experiences of Negroes during the last decade. From an examination of this evidence, I am convinced that it would be a serious mistake to conclude that the black community has been so blessed with the benefits of economic advancement that public policy -- which played such a vital role in the 1960's -- need no longer treat poverty and deprivation among such a large segment of society as a matter of national concern. To accept such a view would certainly amount to neglect -- but it would also be far from benign.

The evidence underlying my assessment is presented in some detail in the rest of these remarks, but the salient conclusions can be summarized briefly:

- During the 1960's, Negroes as a group <u>did</u> make significant economic progress. This can be seen in terms of higher employment and occupational upgrading as well as in lower unemployment and a narrowing of the income gap between Negroes and whites.

- However, beneath these overall improvements, another -- and disturbing -- trend is also evident: within the Negro community, there appears to be a deepening schism between the able and the less able, between the well-prepared and those with few skills.

- This deepening schism can be traced in a number of ways, including the substantial rise in the proportion of Negroes employed in professional and technical jobs -- while the proportion in low-skilled occupations also edges upward; in the sizable decline in unemployment -- while the share of Negroes among the long-term unemployed rises; in the persistence of inequality in income distribution within the black community -- while a trend toward greater equality is evident among white families; above all in the dramatic deterioration in the position of Negro families headed by females.

- In my judgment, this deepening schism within the black community should interest us as much as the real progress that has been made by Negroes as a group.

Before concluding these remarks, I would also like to comment briefly on the new program of family assistance, recommended by the President and now being considered by the Congress. It is my impression that this program is a source of much discussion -- and some apprehension -- within the Negro community. In my personal judgment, there is more reason to support it than to campaign against its enactment.

Let us now turn to a closer examination of each of these main points.

Employment and Occupational Upgrading

The economic progress of Negroes can be traced in the trends of the labor force, employment and occupational advancement during the last decade. In 1969, there were just under 9 million nonwhites in the labor force -- meaning that they were holding jobs or seeking work.

(Well over 90 per cent of nonwhites are Negroes.) This was a rise of 16 per cent since 1960, a rate of increase virtually the same as for whites and for the total labor force. However, employment of nonwhites rose more rapidly than it did for whites (by 21 per cent to 8.4 million for the former compared with 18 per cent to 69.5 million for the latter). Expressed differently, while nonwhites represented about 11 per cent of the total labor force in both 1960 and 1969, their share of the gains in employment during the decade was somewhat larger: they accounted for 12 per cent of the employment growth, although they held just over 10 per cent of the jobs at the beginning of the period.

Advancement in the range of jobs held by Negroes in the last decade was also noticeable. This was particularly true of the improvements in the highest paying occupations. Between 1960 and 1969, the number of nonwhites in professional and technical positions increased by 109 per cent (to 692 thousand) while the increase for whites was only 41 per cent (to 10,031 thousand). By last year, nonwhites had progressed to the point where they accounted for 6-1/2 per cent of the total employment in these top categories in the occupational structure (compared with less than 4-1/2 per cent in 1960), and they got about 11 per cent of the net increase in such jobs over the decade. During this same period, the number of nonwhite managers, officials and proprietors (the second highest paying category) increased by 43 per cent (to 254 thousand) compared to an expansion of only 12 per cent (to 7,721 thousand) for whites. In the 1960's, nonwhite workers left low-paying jobs in agriculture and household service at a rate two to three times faster than did white workers. The number of nonwhite farmers and farm workers dropped by 56 per cent (to 366 thousand) in contrast to a decline of 31 per cent (to just under 3 million) for whites in the same category. In fact, by 1969, nonwhites accounted for the same proportion (11 per cent) of employment in agriculture as their share in the total labor force; in 1960, the proportion for non-whites (at 16-1/2 per cent) was more than 1-1/2 times their share in the total labor force. The exit of nonwhites from private household employment was even more striking. During the last decade, the number of nonwhites so employed fell by 28 per cent (to 712 thousand); the corresponding drop for white workers was only 9 per cent (to 900 thousand). Although roughly half of all household workers were non-white in 1960, the ratio had declined to just over two-fifths by 1969. The number of nonfarm laborers also fell (by 8 per cent to 876 thousand) over the last decade while the number of white laborers rose by the same percentage (to 2,809 thousand).

Nevertheless, as already indicated, the accelerated movement of nonwhites out of the positions at the bottom of the occupational pyramid did not carry through the entire occupational structure. For example, nonwhites in 1969 still held about 1.5 million of the service jobs outside private households -- most of which require only modest skills. This represented one-fifth of the total -- approximately the same proportion as in 1960. Moreover, the number of nonwhites holding semi-skilled operative jobs (mainly in factories) rose by 41 per cent (to about 2 million) during the decade, compared with an expansion of only 17 per cent (to 12.4 million) for whites. The result was that nonwhites' share of the total climbed from 12 per cent to 14 per cent. Taken together, these two categories of low-skilled jobs chiefly in factories or in nonhousehold services accounted for a larger share (42 per cent) of total nonwhite employment in 1969 than they did in 1960 -- when their share was 38 per cent. In contrast, among whites the proportion was virtually unchanged -- 26 per cent at the beginning of the decade and 27 per cent at its close.

While nonwhites made substantial progress during the 1960's in obtaining clerical and sales jobs -- and also registered noticeable gains as craftsmen -- their occupational center of gravity remained anchored in those positions requiring little skill and offering few opportunities for further advancement. At the same time, it is also clear from the above analysis that those nonwhites who are well-prepared to compete for the higher-paying positions in the upper reaches of the occupation structure have made measurable gains. These contrasting experiences should be borne in mind because they point clearly to the deepening schism within the black community.



Trends in Unemployment

Over the 1960's, unemployment among Negroes declined substantially. In 1960, about 787 thousand nonwhites were unemployed, representing 10.2 per cent of the nonwhite labor force. Among whites in the same year, about 3.1 million were without jobs, and the unemployment rate was 4.9 per cent. By 1969, unemployment had dropped by 28 per cent (to 570 thousand) for nonwhites and by 26 per cent (to 2.3 million) for whites. Their unemployment rates had fallen to 6.4 per cent and 3.1 per cent, respectively.

The incidence of joblessness among nonwhites continued to be about twice that for whites during the 1960's. Even in those categories where the most favorable experience was registered, nonwhite unemployment rates remained significantly higher than those for whites. For instance, among married nonwhite males aged 20 years and over, the unemployment rate in 1969 stood at 2.5 per cent, compared with 1.4 per cent for white men in the same circumstances. Nevertheless, one should not lose sight of the fact that -- taken as a group -- Negroes made real strides in escaping idleness in the 1960's.

But, here again, we should not stop with this over-view. On closer examination, one quickly observes that a sizable proportion of the remaining unemployment among Negroes appears to be of the long-term variety. For example, in 1969, just under 20 per cent of the unemployed nonwhites on the average had been without jobs for 15 weeks or longer; among whites the proportion was only 12-1/2 per cent. Moreover, those out of work for more than half a year represented 7 per cent of the joblessness among nonwhites compared with 4 per cent for whites. In 1961, when unemployment rose substantially under the impact of the 1960-61 recession, nonwhites accounted for about 21 per cent of total unemployment and for roughly 24 per cent of those without jobs for at least 3-1/2 consecutive months. However, by 1969, nonwhites made up 27 per cent of the pool of long-term joblessness -- although their share of total unemployment had declined slightly to 18 per cent. So, while a significant number of Negroes did find -- and keep -- jobs during the last decade, a sizable number of others were stuck in idleness for fairly long periods of time.

Still other evidence can be cited which underlines the contrasts within the Negro community. During the first eleven months of 1969, the unemployment rate among nonwhites living in the central cities of the 20 largest metropolitan areas averaged 6.3 per cent; it was a full percentage point less among those living in the suburban sections of these areas. Among nonwhite teenagers (those members of the labor force 16 to 19 years old), the unemployment rate averaged 27 per cent. During the same period of 1969, there was very little difference in unemployment rates between whites living in central cities (3.1 per cent) and those living in suburbs (2.9 per cent), and for white teenagers, the rate was 10 per cent.

So, judged by the differential impact of unemployment -- as well as by the trend of employment and occupational upgrading -- some Negroes have experienced commendable improvement while others have lingered behind in relative stagnation.

Trends in Income: A Reexamination

Undoubtedly, income statistics are probably the most closely watched indicators of economic progress. This is true for Negroes as well as for whites. These figures also demonstrate that the Negro community recorded significant gains during the last decade. In 1961, aggregate money income of families in the United States totaled $306.6 billion, of which whites received $290.4 billion and nonwhites received $16.2 billion. Thus, the nonwhites' share was 5.3 per cent. By 1968, the total had risen to $488.4 billion -- with $454.5 billion going to whites and $33.9 billion going to nonwhites. In that year, the nonwhites' share had risen to 6.9 per cent.

In terms of median family income, the same indication of progress is evident. In 1959, the median income of nonwhite families amounted to $3,164, or 54 per cent of that for whites -- which amounted to $5,893. By 1968, the figure had risen to $8,936 for whites and to $5,590 for nonwhites, thus raising the nonwhite/white ratio to 63 per cent.

These relative family income data are a useful concept for some purposes, but they must be interpreted carefully. Otherwise they yield a misleading picture of the comparative economic status of the nonwhite population. A principal source of error is the failure of data on median family income to account for the fact that nonwhite families on average tend to be substantially larger than white families.

Data on median family income adjusted to a per capita basis to account for much larger minority families are presented in Table 1. (Attached.) When further adjustments are made to differentiate among types of families, several important conclusions result. The first and most important of these is that, for all types of families, nonwhite per capita family income is substantially lower in relation to that for white families than was suggested by the unadjusted figures. It appears that in 1967 the median income data unadjusted for differences in family size may have overstated the relative economic status of nonwhite families by something on the order of 11 per cent.

The information in Table 1 permits a further analysis of growth trends in per capita family income compared to growth trends in relative median family incomes for different types of households. For all families and for husband and wife families, the relative gains on a per capita basis were only slightly less than the relative gains on a total family income basis. The picture for female headed families, however, is completely different. The latter have the lowest median family income in general, and nonwhite families headed by females have the lowest median income compared to their white counterparts. What is perhaps even more disturbing, however, is that -- because of the much larger size of nonwhite female headed households[1] -- the per capita differences

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1/ In 1967, the average Negro husband-wife family was .76 members larger than its white counterpart, but the average Negro female headed family was 1.26 members larger.

in family income are substantially wider than the differences in median family income. In 1967, the ratio of family income per capita of female headed nonwhite families (at 44 per cent) was 18 percentage points lower than the ratio of Negro to white median family income. The data in Table 1 appear to indicate that the gap between white and Negro per capita family income has not been narrowing as rapidly as suggested by the most widely cited income figures.

The conclusion reached by expressing median family income in per capita terms is that the usually observed ratios convey an unrealistic picture of family well-being because they fail to account for the larger absolute size of nonwhite families.

Another indication of the widening gap within the Negro community is provided by the distribution of income among families and individuals at different levels of income. Data showing these trends, by race and broad groupings of income classes, are presented in Table 2.

In examining these data, the first thing to note is that the distribution of income is by no means equal in either the white or non-white community. If it were, each fifth of the families would receive 20 per cent of the aggregate income in each year. In reality, however, only those families around and just above the middle of the distribution come close to receiving approximately this proportion of the total income. The families constituting the lowest fifth receive between 3-1/2 per cent and 6 per cent of the income, while those in the highest fifth receive over 40 per cent of the total. This general pattern of income distribution holds for both white and nonwhite families.

But looking beyond these overall characteristics, it will also be observed that, within the nonwhite community, the distribution of income is considerably more unequal. Among nonwhites, from the lowest through the middle fifth, for each of the years shown, the proportion of aggregate money income received by the families in each category is below that for the white community. The opposite is true for nonwhite families above the middle fifth; their share is greater than that received by white families in the same category. The same tendency is evident when the top 5 per cent of the families with the highest incomes in both groups are compared.

Moreover, in the last few years, the distribution of incomes within the nonwhite community has apparently run counter to the trend among white families. In both the 1961-65 period and the 1965-68 period, the income distribution for white families became more equal. For nonwhite families, the same trend toward greater equality was evident in the first half of the decade. However, it remained roughly constant in the 1965-68 years. And the share received by the top 5 per cent particularly showed no further tendency to decline.

Again, these figures seem to underline a conviction held by an increasing number of observers: a basic schism has developed in the black community, and it may be widening year-by-year.

Poverty in the Negro Community

Poverty is a difficult concept to define in any meaningful sense. Yet, quantitative estimates are necessary if policymakers are to have reliable information on which to make decisions. Since 1965, the United States Government has relied on the estimates developed by the Social Security Administration which, for whatever their defects, appear to be the most reliable data available. The poverty concept developed by the Social Security Administration classifies a family as poor if its income is not roughly three times as great as the cost of an economy food plan for a family of that particular size and farm or nonfarm residence. In 1968, a nonfarm family of four was assumed to be living in poverty if its total money income was less than $3,553. The income deficit of a family is that amount required to raise its income to the poverty threshold.

Table 3 reviews the 1959-68 record of the escape of individuals from poverty. These data demonstrate quite clearly that the rate of decline of poverty for whites has been substantially faster than the rate of decline for nonwhites. Between 1959 and 1968, poverty among whites declined by 39 per cent while poverty among nonwhites declined by 27 per cent. Thus, in 1968 nonwhites made up a greater proportion of the total poor population than they did in 1959 -- the fraction increasing from 27.9 per cent to 31.5 per cent. This much more rapid rate of exodus by whites from poverty is explained by the fact that in 1959 the average poor white family was not nearly as deeply in poverty as the average poor nonwhite family. In 1959, the median income deficit for white families was only $868 while for nonwhites it was $1,280, or 47.5 per cent higher. Clearly, it took less economic achievement to lift the average white family out of poverty. It should be further noted that in 1968 the median income deficit for poor nonwhite families was $1,260 while for white families it was only $907, a difference of 38.9 per cent. Thus, these figures suggest that the future will continue to witness a more rapid rate of escape from poverty by whites than by nonwhites.

The data in Table 3 are of further interest because they permit an analysis of changes in poverty status by type of family. Disaggregating the poverty data into male and female headed families highlights several important points. Between 1959 and 1968, the rate of decline in poverty among individuals in male headed families of whites and nonwhites was roughly equal and also rather rapid. In 1968, the number of individuals classified as poor in male headed households for both races was roughly half the number in 1959.

Distressingly, however, for female headed families, the pattern was quite different. For the white population, the rate of decline among poor individuals in female headed families was substantially below the rate for individuals in male headed families. By 1968, there were only 16 per cent fewer poor individuals in white female headed households compared with 1959. For nonwhites, the data on changes in poverty among individuals in female headed families are extremely disturbing. Between 1959 and 1968, the number of nonwhites in poor female headed families increased by 24 per cent, and the number of nonwhite family members under 18 rose by an alarming 35 per cent. Between 1959 and 1968, there was an absolute increase of 609 thousand nonwhite family members 18 or less classified as poor living in a female headed family. So while the 22 million Negroes constituted only 11 per cent of the country's total population in 1968, the 2.3 million poor children in nonwhite families headed by females represented 52 per cent of all such children.

The data on the rate of escape from poverty for different types of families also emphasize the development of a serious schism within the Negro community. Negroes in stable male headed families appear able to take advantage of economic growth and are leaving poverty at roughly the same rates as whites. The opposite appears true for families headed by a female, who appear unable to earn a sufficient income to escape poverty. The rapid increase in the number of poor nonwhites in female headed families -- and particularly the very rapid rise of children 18 and under in their families -- suggests that the problem of poverty in the black community has by no means disappeared.

Having discussed recent changes in the overall poverty population, it is important to examine briefly the rural experience. For farm families the record is much more encouraging with a decline of almost three-fourths in the number of poor individuals in nine years. Moreover, the rate of decline was roughly equal for whites and nonwhites. These results may in part reflect a growing prosperity in agriculture, but in large part they are due to a migration of the poor of both races from rural to urban settings.

The conclusions from this section are that nonwhite poverty in general has not declined as rapidly as white poverty, primarily because nonwhites classified as poor tended to be substantially poorer than whites classified as poor. This section has also shown that in the last decade there has been an alarming rise in the number of poor nonwhite children under 18 living in female headed families.

Prosperity in the Negro Community: The Importance of Education

The above discussion has obviously reflected a rather pessimistic assessment of several aspects of economic developments in the Negro community -- focusing as it did on nonwhite poverty and the fact that actual white-nonwhite income discrepancies are wider than commonly observed statistics would suggest. To stop here, however, would present a somewhat unbalanced view of Negro economic progress. To present a more balanced picture, it is important to consider the source of some of the recent gains within the Negro community. In particular, it is important to discuss the role of education.

Recent data suggest that Negroes are making considerable gains in both secondary and higher education. Between 1960 and 1969, the per cent of Negro males aged 25 to 29 who had completed 4 years of high school or more increased from 36 per cent to 60 per cent while the white fraction increased from 63 per cent to 78 per cent. Thus, in 1960 the gap had been 27 percentage points, and in nine years this gap had narrowed to only 18 percentage points. In 1968, for the first time a greater percentage of Negro males aged 25-29 completed high school than Negro females.

In the case of higher education, the gains also have been impressive. Table 4 presents data on trends in Negro college enrollment between 1964 and 1968. In these four years, the number of Negroes in college rose by 85 per cent. What is more striking, however, is the fact that during this period, 82 per cent of this enrollment growth occurred in institutions other than the predominantly Negro colleges. Thus, in only four years, the per cent of Negro college students enrolled outside predominantly Negro colleges increased from 49 per cent to 64 per cent. This fact suggests that the larger institutions are becoming increasingly aware of minority problems and are making a concerted effort to assist minority group students. In four years the number of Negro students at these institutions has more than doubled.

The importance of higher education in the economic achievements of whites and Negroes is underlined by the data in Table 5. It is clear that median incomes for men of both races increase dramatically with increasing amounts of education. What is even more important, the ratio of Negroes' income to that of whites rises as the level of education climbs. Stated in a slightly different fashion, the relative gaps within the Negro community between those with higher education and those with lower education are wider than for whites. In 1968 a Negro man, aged 25-54, with a high school education had an income 29 per cent above that for a Negro man with only an 8th grade education, while for whites this gap was 26 per cent.

The case of a Negro with some higher education is of particular interest. This is a man with the highest absolute income and the highest income relative to whites. Unfortunately, due to the unavailability of more data, the figures in Table 5 probably seriously understate the contribution of higher education to Negro income. The last line in Table 5 shows the income of whites and Negroes with 1 or more years of college. This category is really a composite of the categories 1 to 3 years of college and 4 or more years of college. Of all Negro men 25 years of age or over in 1967 reporting one or more years of college, 60 per cent were concentrated in the 1-3 year category. For all white men reporting more than 1 year of college, there was a much greater tendency to have four or more years of college, with only 42 per cent concentrated in the 1-3 year class. If a more complete breakdown of the data in Table 5 were available, they would probably indicate a higher return to Negro higher education.

A second reason why the data in Table 5 may understate the returns to higher education for Negroes is that they fail to account for the age distribution of those achieving higher education. Since major education gains among Negroes have been a rather recent occurrence the better educated Negro man will be substantially younger than his white counterpart. Table 6 documents this point by comparing educational achievements of whites and Negroes at similar age levels. These data show conclusively that the differences in educational achievements are in large part a function of age with the widest gaps among the older segments of the population. It is clear that the best educated within the Negro community are much more highly concentrated in the younger age brackets. Since income increases directly with age, when education is held constant,[1] due to factors of experience and promotions based on length of service, the failure of the data in Table 5 to account for the relatively younger age distribution of the better educated Negro population seriously underestimates the returns to education for Negro males. The figure for white males with higher education refers to an older population and thus, in part, reflects returns to age and experience as well as returns to education. Unfortunately, we will have to wait until the processing of the 1970 Census has been completed to get more complete data.

The conclusions from this discussion of education then are much more encouraging than the results reached above. Younger Negroes

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1/ In 1967, the median income of all males aged 25-34, with four years of college, was $8,716, for those with the same education, aged 45-54, it was $12,267, or 40.7 per cent higher.

are making substantial progress in achieving secondary and higher education, and this increased education is associated with higher absolute income and income relative to whites.

Negroes and the Family Assistance Program

As I indicated above, I would like to comment briefly on the proposal to change significantly the principal means through which the Federal Government provides assistance to needy families. In recent years, these programs have become an important source of income for many Negro families headed by females in which a sizable number of children are found. Thus, one can readily understand why the President's recommendation to change them submitted to Congress in August, 1969, has generated so much discussion (and some apprehension) in the Negro community.

It will be recalled that, in broad outline, the proposed family assistance program would have the Federal Government pay a basic income to all families who could not provide for themselves -- whether they are employed or unemployed. It would be geared to dependent families with children. It would replace entirely the largest of the Federally supported public assistance programs (i.e., aid to families with dependent children). Under the proposal, persons (except mothers with preschool children) who accept assistance would be required to register for work or training. It is estimated that in the first year of the program, over half of the families covered would have one member employed or undergoing training.

As recommended to Congress, the family assistance program would work in the following fashion: A family's basic allowance would consist of $500 for the first two members and $300 per member for each additional member. Thus, for a family of four, the allowance would be $1,600 per year.

Cash payments to families would be computed by adjusting the basic allowance to account for the earnings of the family. The first $720 of family income would not affect the payments because it is assumed that there are basic costs of transportation, lunches, clothing, etc., associated with taking a job. Cash payments to families would then be reduced by 50 cents for each additional dollar of earnings above the $720 minimum.

A simple numerical example will illustrate the program's operation. Assume a family of four has a cash income of $2,000. The first $720 of this income would be disregarded, leaving a balance of $1,280. A family's cash payment would then be reduced by half this amount, or by $640. Since the family's basic allowance was $1,600, its cash payment after earnings would be $960.

So far only a rough idea can be provided with respect to the probable coverage of the family assistance program. The projections available are shown in Table 7, as prepared by the Department of Health, Education and Welfare in February of this year. According to these estimates, in 1971, about 3.3 million families would be covered; of these 2 million (three-fifths) would be white, and 1.3 million (two-fifths) would be nonwhites. These families would include close to 18 million persons -- of whom 44 per cent would be nonwhites. Gross payments would approximate $3.5 billion, and nonwhites would receive about $1.5 billion -- or 43 per cent. These annual payments would average around $1,060 for all families, about $1,000 for white families, and about $1,154 for nonwhites. However, since nonwhite families are expected to be somewhat larger (averaging 6.0 members vs. 5.1 members for whites and 5.4 members for all families), payments per capita would be about the same: $196 for all families, $198 for whites, and $192 for nonwhites.

It is difficult to compare the differential impact of the proposed program on particular groups of families compared with the existing program. However, it appears that a somewhat greater proportion of the families covered by the new program would be white compared with those covered by aid to families with dependent children (AFDC). In 1968, there were 1.5 million families participating in AFDC, involving 6.1 million persons, of whom 4.6 million were children. Outlays under the Federally aided programs amounted to $3.4 billion, and the average monthly payment per family was $168 (just over $2,000 per year).

In 1967, according to an HEW survey conducted in 1968, about 51.3 per cent of the families covered by AFDC were white, 46 per cent were Negro, and 2.7 per cent were other nonwhites. In 1961, whites constituted 51.8 per cent of the total, Negroes 43.1 per cent, and other nonwhites made up the remaining 5 per cent. So during the decade of the 1960's, Negroes as a proportion of total AFDC coverage increased while the proportion for all other groups was declining.

On balance, it appears that the new family assistance program would represent a considerable improvement -- compared with the existing AFDC program -- in about 20 States. Of these, 14 are Southern States (with a heavy concentration of Negroes), and most of the remainder are Western States (with a sizable proportion of Indians and Mexican-Americans among their populations). In 1968, the average annual payment under AFDC in the 14 Southern States was approximately $1,116. However, the average payment varies greatly among these States, and in some it is much below $1,000. Thus, given an annual payment of $1,600 for a family of four, there would be an increase of roughly $480 (or well over 40 per cent) compared with the amounts received by the average AFDC family in this region. While the exact status of families under the old and new programs cannot be determined, there appears to be no doubt whatsoever that the new proposal would result in a real improvement.

In 30 States there would also be an opportunity to make further improvements. However, in these cases, the outcome would depend on whether the States and local governments maintained their existing programs at substantially the same level. If these outlays were held at no less than 90 per cent of the 1968 level, assisted families would be better off in virtually every instance. Under the existing AFDC program, the average annual payment in these States in 1968 was $2,195 (of which $1,044 represented non-Federal payments). Under the new program (and assuming the 90 per cent maintenance factor), the average payment per family would rise to about $2,536. Thus, the new arrangement would imply an increase of roughly $340, or 15 per cent. The 30 States include primarily the heavily populated northern industrial States plus California. Most of these have a sizable concentration of low-income nonwhites in urban areas.

So, while these estimates of the probable improvement which might accrue under the new program of family assistance are obviously crude, they are suggestive. They imply that Negroes -- and particularly the poverty-stricken families headed by females -- would benefit substantially. And above all, it would create a promising basis for checking the increased dependence on public welfare of a growing segment of the population.

## Concluding Observations

The analysis presented here has sketched a rather mixed picture of economic progress among Negroes in the United States. While not meaning to deny or demean the recent impressive economic gains by Negroes, we must be careful that no one is lulled into believing (falsely) that the economic problems of Negroes have been solved. In this regard, the commonly observed income statistics, when accepted at face value, convey an unwarranted sense of greater economic parity between whites and Negroes than actually exists.

It was also noted that a closer analysis of the available data shows clearly that a definite economic schism has arisen within the Negro community. Individuals in male headed households appear able to share fairly well in economic advances, while those in female headed households are sinking backwards into poverty. Those individuals who have prepared themselves for challenging careers by seeking and obtaining higher education are registering relatively large improvements in incomes, while those without such training are falling further behind. Clearly, the economic condition of those who currently are lagging should be made a matter of serious national concern.

For this reason, the proposed family assistance program is pointing in the right direction, and -- despite reservations many might have about some of its components -- it should be viewed with greater receptivity within the Negro community.

Table 1

Family Income Adjusted to Per Capita Basis, by Type of Family, by Race of Head, 1959 and 1967

| | All Families | | Husband-wife Families | | Female-Headed Families | |
|---|---|---|---|---|---|---|
| | 1959 | 1967 | 1959 | 1967 1/ | 1959 | 1967 1/ |
| Median Family Income | | | | | | |
| White | 5893 | 8274 | 6089 | 8269 | 3538 | 4879 |
| Nonwhite | 3164 | 5141 | 3663 | 5854 | 1734 | 3015 |
| Ratio | .54 | .62 | .60 | .71 | .49 | .62 |
| Persons Per Family | | | | | | |
| White | 3.58 | 3.59 | 3.66 | 3.66 | 2.93 | 3.03 |
| Nonwhite | 4.31 | 4.35 | 4.42 | 4.42 | 4.04 | 4.29 |
| Per Capita Family Income | | | | | | |
| White | 1646 | 2305 | 1664 | 2358 | 1208 | 1610 |
| Nonwhite | 733 | 1182 | 829 | 1324 | 429 | 703 |
| Ratio | .45 | .51 | .50 | .56 | .36 | .44 |

1/ Data for 1967 refer exclusively to Negroes.

Source: U.S. Department of Commerce, Bureau of the Census, Income in 1967 of Families in the United States, Series P-60, No. 59, April 18, 1969, and, U.S. Census of Population: 1960, Vol. 1, Characteristics of the Population. Part 1, United States Summary, 1964

Table 2. Trends in the Income of Families in the United States: 1950 to 1968

| INCOME RANK | 1968 | 1967 | 1965 | 1961 | 1950 |
|---|---|---|---|---|---|
| FAMILIES | | | | | |
| TOTAL - ALL RACES | | | | | |
| PER CENT | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| LOWEST FIFTH | 5.7 | 5.4 | 5.3 | 4.8 | 4.5 |
| SECOND FIFTH | 12.4 | 12.2 | 12.1 | 11.7 | 12.0 |
| MIDDLE FIFTH | 17.7 | 17.5 | 17.7 | 17.4 | 17.4 |
| FOURTH FIFTH | 23.7 | 23.7 | 23.7 | 23.6 | 23.5 |
| HIGHEST FIFTH | 40.6 | 41.2 | 41.3 | 42.6 | 42.6 |
| TOP 5 PER CENT | 14.0 | 15.3 | 15.8 | 17.1 | 17.0 |
| WHITE | | | | | |
| PER CENT | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| LOWEST FIFTH | 6.0 | 5.8 | 5.6 | 5.2 | 4.8 |
| SECOND FIFTH | 12.7 | 12.5 | 12.5 | 12.1 | 12.2 |
| MIDDLE FIFTH | 17.7 | 17.5 | 17.7 | 17.3 | 17.3 |
| FOURTH FIFTH | 23.4 | 23.5 | 23.4 | 23.2 | 23.1 |
| HIGHEST FIFTH | 40.3 | 40.7 | 40.8 | 42.2 | 42.5 |
| TOP 5 PER CENT | 14.0 | 14.9 | 15.5 | 17.3 | 17.6 |
| NEGRO AND OTHER RACES | | | | | |
| PER CENT | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| LOWEST FIFTH | 4.8 | 4.4 | 4.6 | 4.0 | 3.5 |
| SECOND FIFTH | 10.5 | 10.4 | 10.7 | 9.7 | 10.2 |
| MIDDLE FIFTH | 16.5 | 16.4 | 16.5 | 15.9 | 17.6 |
| FOURTH FIFTH | 24.6 | 24.1 | 24.7 | 24.3 | 25.2 |
| HIGHEST FIFTH | 43.6 | 44.7 | 43.5 | 46.0 | 43.5 |
| TOP 5 PER CENT | 16.1 | 17.5 | 15.5 | 17.4 | 16.6 |

Table 3

Persons Below Poverty Level in 1959 and 1968,

by Family Status and Sex and Race of Head
(Numbers in Thousands)

| | 1959 | 1968 | Percentage Change |
|---|---|---|---|
| White, Total | 28,484 | 17,395 | -38.9 |
| In Families with Male Head, Total | 20,211 | 9,995 | -50.5 |
| Head | 4,952 | 2,595 | -47.6 |
| Family Members under 18 | 8,966 | 4,298 | -52.1 |
| Other Family Members | 6,293 | 3,102 | -50.7 |
| In Families with Female Head, Total | 4,232 | 3,551 | -16.1 |
| Head | 1,233 | 1,021 | -17.2 |
| Family Members under 18 | 2,420 | 2,075 | -14.3 |
| Other Family Members | 579 | 455 | -21.4 |
| Unrelated Individuals | 4,041 | 3,849 | - 4.8 |
| Negro and Other Races, Total | 11,006 | 7,994 | -27.4 |
| In Families with Male Head, Total | 7,337 | 3,710 | -49.4 |
| Head | 1,452 | 697 | -52.0 |
| Family Members under 18 | 4,097 | 2,032 | -50.4 |
| Other Family Members | 1,788 | 981 | -45.1 |
| In Families with Female Head, Total | 2,782 | 3,439 | +23.6 |
| Head | 683 | 734 | + 7.5 |
| Family Members under 18 | 1,725 | 2,334 | +35.3 |
| Other Family Members | 374 | 371 | - 0.8 |
| Unrelated Individuals | 887 | 845 | - 4.7 |

Source: U.S. Department of Commerce, Bureau of the Census, Poverty in the United States 1959 to 1968, Series P-60, No. 68, December 31, 1969.

Table 4

Negro College Students Enrolled in 1964 and 1968,
by Type of Institution
(Numbers in thousands)

| | 1964 (Fall) | 1968 (Fall) | Change, 1964-68 Number | Percent |
|---|---|---|---|---|
| Total Enrollment | 4,643 | 6,801 | 2,158 | 46 |
| Total Negro Enrollment | 234 | 434 | 200 | 85 |
| Percent total enrollment | 5 | 6 | (X) | (X) |
| Enrollment in predominantly Negro colleges | 120 | 156 | 36 | 30 |
| Percent of all Negroes in college | 51 | 36 | (X) | (X) |
| Enrollment in other colleges | 114 | 278 | 164 | 144 |
| Percent of all Negroes in college | 49 | 64 | (X) | (X) |

(X) Not applicable.

Source: U.S. Department of Labor, Bureau of Labor Statistics; U. S. Department of Commerce, Bureau of the Census; U. S. Department of Health, Education and Welfare, Office of Education

Table 5

Median Income of Men 25 to 54 Years Old, by Educational Attainment, 1968

| | | Median income, 1968 | | Negro income as a percent of white |
|---|---|---|---|---|
| | | Negro | White | |
| Elementary: | Total | $3,900 | $5,844 | 67 |
| | Less than 8 years | 3,558 | 5,131 | 69 |
| | 8 years | 4,499 | 6,452 | 70 |
| High School: | Total | 5,580 | 7,852 | 71 |
| | 1 to 3 years | 5,255 | 7,229 | 73 |
| | 4 years | 5,801 | 8,154 | 71 |
| College: | 1 or more years | 7,481 | 10,149 | 74 |

Source: U.S. Department of Commerce, Bureau of the Census

Table 6

Median Years of School Completed for Persons 20 years of Age and Over, by Age, 1969

| Age | White | Negro | Difference |
|---|---|---|---|
| 20 - 21 years old | 12.8 | 12.2 | .6 |
| 22 - 24 years old | 12.7 | 12.2 | .5 |
| 25 - 29 years old | 12.6 | 12.1 | .5 |
| 30 - 34 years old | 12.5 | 12.0 | .5 |
| 35 - 44 years old | 12.4 | 10.6 | 1.8 |
| 45 - 54 years old | 12.2 | 9.1 | 3.1 |
| 55 - 64 years old | 10.9 | 7.6 | 3.3 |
| 65 - 74 years old | 8.9 | 6.1 | 2.8 |
| 75 years old and over | 8.5 | 5.2 | 3.3 |

Source: U.S. Department of Commerce, Bureau of the Census

Table 7

Racial Distribution of Recipients
Under the Proposed Family Assistance Program:
1971 Projection

(Numbers in millions; amounts in billions of dollars)

| Race | Families Covered | | Persons Covered | | Gross Payments | |
|---|---|---|---|---|---|---|
| | Number | Per Cent | Number | Per Cent | Amount | Per Cent |
| White | 2.0 | 60.6 | 10.1 | 56.4 | 2.0 | 57.1 |
| Nonwhite | 1.3 | 39.4 | 7.8 | 43.6 | 1.5 | 42.9 |
| Total | 3.3 | 100.0 | 17.9 | 100.0 | 3.5 | 100.0 |

Source: Department of Health Education and Welfare, "Selected Characteristics of Families Eligible for Family Assistance Plan: 1971 Projection," February 2, 1970.