



1994 ANNUAL REPORT

LATIN AMERICA
AND THE SOUTHEAST

Federal Reserve Bank of Atlanta

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Federal Reserve Bank of Atlanta

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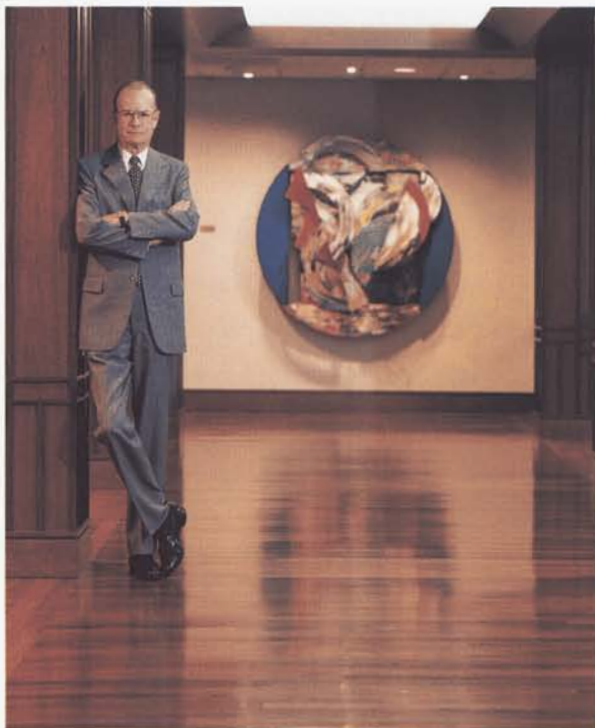
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MESSAGE FROM THE PRESIDENT

The 1994 annual report of the Federal Reserve Bank of Atlanta features some of our accomplishments for the year along with the consolidated financial statements of the Bank's six offices. The names of all directors and officers who served the Sixth District during the past year are listed as well.

In addition to the review of the year's developments, this report includes a discussion of Latin America and its trade relationship with the United States, particularly the Southeast. The essay examines recent developments in Latin American economies and projects long-term growth for the area as a whole. To realize fully the potential benefits of a relationship with our neighbors to the south, it will be important for the Southeast to build on the strengths that have made it a forerunner in the U.S. economy.

I would like to express my appreciation to all of the Sixth District's directors for their valuable counsel throughout the year. In particular, I want to acknowledge those directors whose service ended or who resigned in 1994—Victoria B. Jackson, of the head office board; S. Eugene Allred, chairman of the Birmingham board; Samuel H. Vickers, chairman, and Perry M. Dawson, of the Jacksonville board; Dorothy C. Weaver, chairman, and Roberto G. Blanco, of the Miami board; and William Baxter Lee III, Harold A. Black, and Marguerite W. Sallee, of the Nashville board.



Robert P. Forrestal

Robert P. Forrestal
President and
Chief Executive Officer

LATIN AMERICA AND THE SOUTHEAST

BY ROBERT P. FORRESTAL

Latin America has seen a tremendous turnaround in its fortunes over the past few years with the introduction of market-based reforms. Besides a considerable decline in overall debt and inflation for the region, many countries have seen strong economic growth. In addition, more countries within Latin America have instituted trade linkages, such as the Andean Common Market and MERCOSUR, and not only has Mexico joined the North American Free Trade Agreement but Chile has been designated the next in line to join.

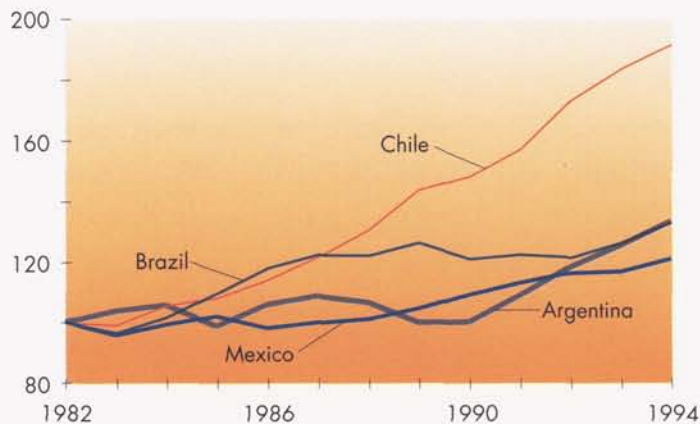
Despite the many positive results in the region as a whole, whenever anyone begins to talk about Latin America now, foremost in the minds of many is the sharp decline in the Mexican peso that began in December and the ensuing financial problems. These events have certainly colored the current financial situation in Latin America, but it is difficult to forecast their effects. However, Latin American economies remain fundamentally quite strong, and they should be able to persevere through the latest financial problems. It would not be possible to understand the present state of affairs without some background information about the economic transformation Latin American countries have undertaken during the past several years. Reviewing this transformation will set the stage for the discussion of Latin America's potential for increased free trade and the implications for the United States and the Southeast.

LATIN AMERICA IN TRANSITION

Over the past decade, Latin American nations have undergone profound economic and political change—and those changes have been for the better. Not too long ago, most countries in the region were beset by huge external debt burdens, rampant inflation, crushing government budget deficits, and general economic and financial malaise. In the wake of significant macroeconomic reforms, we have begun to see economic growth (see Chart 1), a significant return of capital that had fled these countries in search of safer investment opportunities abroad, and—at least before the peso shock—an increase in foreign investment. Democracy and free-market economies are now the norm where dictatorships and centralized economies once prevailed. Since these have been dramatic and far-reaching changes, it would not be realistic to think that these nations could make this transition without occasional setbacks. In the long run, however, Latin America will be an increasingly important economic force in the world.

Overall, it is important to remember that the desirability of closer international economic integration has not been negated by the recent developments in Mexico. It is also worth noting that, although Mexico's growth may slow following the depreciation of the peso, other countries in Latin America are expected to continue to do well. For example, Chile's prudent economic policies have enabled it to post positive rates of growth averaging 5 percent over the last decade. Chile has a

Chart 1
Gross Domestic Product in Four Major
Latin American Countries, 1982-94
(Inflation-adjusted, 1982=100)



Computed by the Federal Reserve Bank of Atlanta using data from International Monetary Fund, Consensus Economics. Data for 1994 are estimates.

high domestic savings rate and a financial system that is less susceptible than some of its neighbors' to destabilizing outflows of capital. Both of these attributes should help it through the fallout from the Mexican peso depreciation. In essence, Chile is an example of a country that is benefiting from the kind of economic and political stability other Latin American nations are striving toward.

It is true that there have recently been problems in Latin America, including Mexico's economic troubles, the resulting effects upon foreign investment in that country and others in Latin America, and financial problems in Venezuela. In addition, some Latin American countries still face serious obstacles to continuing growth, chief among them being a lack of strong financial systems and comprehensive bank supervision. The recipe for continued long-term, stable growth in Latin America—in addition to the macroeconomic policies that have already been put in place—is to have a strong financial system of well-regulated banks and an efficient payments system in place in each country. Such a financial system requires an independent central

If we in the United States want to ensure that our Latin American neighbors remain on the path they have chosen, we must persist in our efforts to forge closer economic ties with them through increased trade.

bank to ensure that monetary policy making is separate from fiscal decision making and is not vulnerable to political pressure by members of the government.

If we in the United States want to ensure that our Latin American neighbors remain on the path they have chosen, we must persist in our efforts to forge closer economic ties with them

through increased trade. Expanding the North American Free Trade Agreement (NAFTA) to include other Latin American economies that have embarked on market-oriented policy reforms is a logical next step to achieve this goal. The Free Trade Area of the Americas (FTAA), launched in Miami in 1994, should remain a top priority for the United States.

An expanded FTAA may also serve to consolidate the many regional trade pacts that have sprung up in Latin America, which include the Andean Common Market (Bolivia, Colombia, Ecuador, Peru, and Venezuela) and MERCOSUR (the Southern Cone Common Market—Argentina, Brazil, Paraguay, and Uruguay). While it is legal for such regional pacts to exist within the framework of the General Agreement on Tariffs and Trade (GATT), so long as they do not institute more restrictive trade policies than allowed under GATT, there is the abiding question of whether they serve to create more trade or to divert it from countries that are not included in the pacts. Economists are not entirely agreed on this point, except to say that the ideal free trade area is worldwide in scope. As GATT or the World Trade Organization proceeds slowly and painstakingly towards its goal of global free trade, perhaps it should not be so surprising that countries in close proximity to one another should decide to band together to increase their economic welfare through free trade. MERCOSUR is no different from the European Community or NAFTA in that regard. Put in the best light, all of the trade pacts around the world can be thought of as pilot projects for global free trade as long as they do not purposely erect barriers to

trade outside the area. The ideal situation in lieu of a completed GATT would be for these trading groups to be open to adding new members as a move toward a broader trade pact.

THE IMPORTANCE OF FREE TRADE

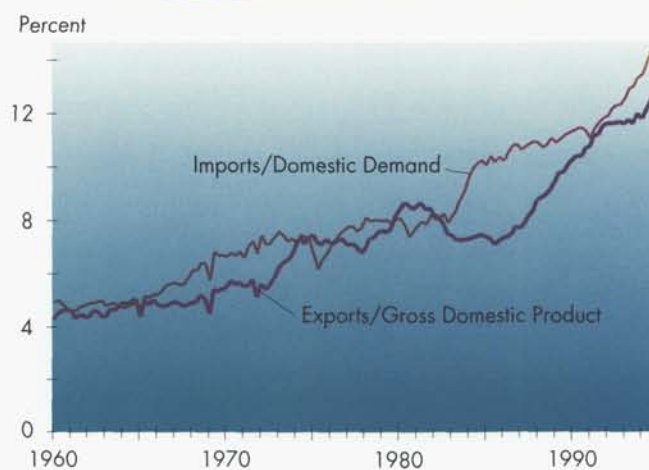
As an adjunct to this brief discussion of trade pacts, a description of the long-term good brought about by free trade in general is in order. Essentially, free trade enhances the welfare of all countries involved. People in all countries that trade freely with one another are able to purchase goods and services that would not otherwise be available to them or would be available only at a higher cost. On the other side of the equation, the production of these goods and services adds to the income of each country.

In the United States, we have become so accustomed to the benefits of generally moderate (and declining) trade barriers that we sometimes take them for granted. For instance, on the consumption side, a wide array of consumer goods—from Brazilian shoes to Chinese toys—is available at reasonable prices that would not be possible if U.S. trade restrictions were tighter. On the production side of the free-trade equation, this nation has benefited from the creation of additional jobs as a result of both importing and exporting activity. Over the past twenty years, the United States has become much more export- and import-oriented (see Chart 2). While the latter has resulted in some job losses, on balance the increase in trade-related jobs has contributed to the overall

increase in employment.

Free trade allows each country to benefit from its comparative advantages with other countries in what can be described as a “win-win” situation. The theory of comparative advantage shows why it is not optimal for countries to be self-sufficient. To understand the benefits of

Chart 2
U.S. Foreign Trade, 1960-94
(Constant Dollar)



Computed by the Federal Reserve Bank of Atlanta using data from Haver Analytics, New York.

comparative advantage, we can begin by looking at the concept within the context of our fifty states. For example, it clearly is wiser for Georgia not to try to produce its own citrus fruits or energy resources, such as oil, mainly because it does not have the natural attributes to do so. Georgia could develop alternative in-state supply sources through, say, the use of greenhouses or wood, but citrus fruit can more cheaply come from Florida (or Mexico or South America) and the energy resources can come from Louisiana (or the Middle East).

Meanwhile, Georgia has an advantage in supplying other states or parts of the world with some of the items it is good at producing, such as poultry and lumber. These examples

From the United States' point of view, we are better off when our neighbors to the south as well as to the north are thriving economically—thus increasing their imports from us—rather than deteriorating.

rest, at least partly, on absolute advantages in resource availability, but the same points hold even when there is only a comparative advantage. Georgia might be quite good, even better than another state, at producing automobiles, but if Georgia can make paper relatively more efficiently than that other state, both are better off if Georgia concentrates on paper and the other one on autos.

In recent years, economists have increasingly recognized that comparative advantage can be based on economies of scale or agglomeration effects, not just on differences in climate or natural resources. If an industry is concentrated in a particular geographic area, new ideas and technological advances can spread through the industry quickly. Moreover, a concentrated industry can support a variety of specialized suppliers that become highly efficient at their jobs. For example, the concentration of movie and television production in Hollywood supports an array of suppliers, from caterers who bring food to the set to film labs that edit the finished product. In the Southeast, Atlanta may be developing as a center for communications services, and Orlando is a major vacation destination, with the many theme parks and attractions that have been built there.

The same logic works on a wider scale, at the global level. The United States is a leader in supplying higher value-added items, such as computer software, while other countries assemble the hardware. Similarly, the United States does not emphasize production of videotapes but, rather, the creation of the movies that go on videotapes. This comparative advantage derives from having a large group of creative, highly skilled workers. It works to the United States' benefit because other countries that lack the numbers of such workers find it difficult to produce items such as movies or software in significant quantities, whereas it is easier for them

to copy the relatively low-skill technology for duplicating videotapes or assembling computer hardware.

U.S. gains in areas that use the newest technology and call for highly skilled and more educated workers have been changing the composition of the nation's exports from lower value-added products like food, bulk chemicals, and other commodities. In the Southeast, in contrast, such lower value-added products remain the chief exports (see Chart 3). However, low-skill,

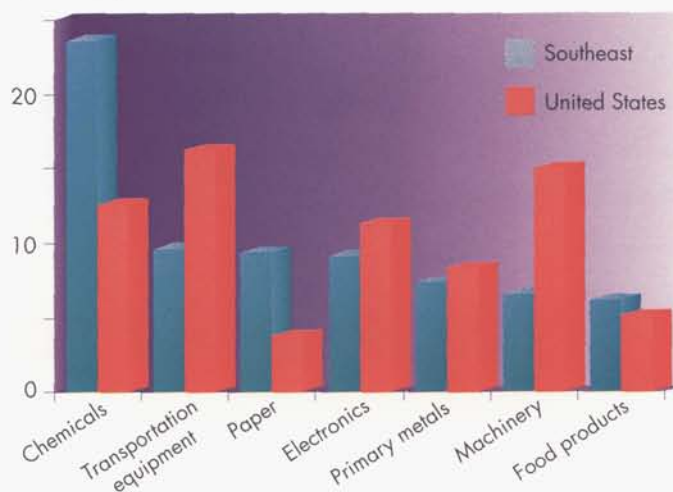
labor-intensive jobs,

like many piecework jobs in the apparel industry, have been

moving to other nations that have much lower-paid labor, particularly China and other Pacific Rim countries, and the Southeast has felt the effects of this shift. For example, southeastern apparel employment as a share of manufacturing employment has declined from 13 percent in 1977 to 10 percent in 1994.

Chart 3
Composition of Southeastern and U.S. Export-Related Manufacturing Shipments, 1989

Percent of Exports



Computed by the Federal Reserve Bank of Atlanta using data in *Exports from Manufacturing Establishments, 1989*, U.S. Department of Commerce. Data for 1989 are the most recently available reliable data. Industry shares have proved relatively stable over time.

Such change certainly entails transition costs such as factory shutdowns and job losses for those individuals and communities in the Southeast and nation that once relied on industries like apparel as a main source of employment and income. It is true, to be sure, that this course of events is natural for a dynamic, wealthy country like the United States. Would we really want to go back to creating sweatshops of poorly paid workers in our nation simply to keep these low-paying jobs within our borders? We are ultimately better off creating the kinds of products and services whose added value is higher and optimizes our comparative advantage in the world. This process of change, however, cannot happen overnight. It involves raising the educational level of all Americans so that an increasing number will possess the education and skills needed in the production of higher value-added items. Unfortunately, in the South, where investment in primary and secondary education has historically lagged behind the nation's, this lag represents

a serious stumbling block in our bid to continue long-term growth and expand exports. This is not a new argument in regard to the South, but it cannot be ignored in the face of mounting pressure to compete not only with other regions in the United States but also with other countries in the world.

In areas of the country where low-skill, low-wage jobs are common, as in the South, so too is sentiment toward protectionism. Therefore, it is particularly important to increase understanding about how free trade benefits those countries involved over the long run. There is still a widespread view that trade is essentially static; that is, it is frequently thought of as part of a pie that always stays the same size. Too often we hear international trade discussed in terms of job losses, forgetting that jobs are also created through trade. In fact, trade is dynamic. The more trade there is, the larger the pie gets, with the result that no country loses in the long term. Consider Mexico and NAFTA, for example. Even though that country is currently dealing with economic problems stemming from the depreciation of the peso against the dollar, over time the new system of free trade will allow Mexicans to create more jobs. Higher income from these jobs will enable Mexican workers to purchase more U.S. goods and services. In the long run, both countries will be better off.

IMPLICATIONS FOR THE UNITED STATES AND THE SOUTHEAST

Obviously, it is encouraging to see the great strides made toward market economies in Latin America because the resulting stronger economies also create more opportunities for trade. But what exactly are the implications for the United States and the Southeast? At the most fundamental level, the result will be more jobs—jobs in the United States and jobs in Latin America, a net employment gain tied to increased trade. According to the Commerce Department, U.S. manufacturing exports to the world increased by 95 percent in the period between 1987 and 1993, whereas they increased by 138 percent to Latin America and the Caribbean. Argentina, Chile, Colombia, and Mexico saw the greatest increases in manufacturing imports from the United States during that period. Unlike the vicious cycle of retaliation that protectionism leads to, free trade on balance creates jobs, making all countries better off.

Once the benefits of free trade are recognized, the next question is where the United States and, in particular, the Southeast, should focus its exporting efforts. Proximity is one of the characteristics of enduring trading partners, and the current experience of the United States bears this out: Canada is our number one export market and Mexico virtually shares second place with Japan, whose economy is much larger. Thus, from a purely geographic perspective, trade with our neighbors to the south makes good sense. But there are other reasons to focus trade efforts on Latin America. From the United States' point of view, we are better off when

our neighbors to the south as well as to the north are thriving economically—thus increasing their imports from us—rather than deteriorating. In view of Mexico's current problems, it may seem that now is not the right time to be recommending that the United States and the Southeast look southward for trade opportunities. But one must take the long view when thinking about trade, and in the long view the focus should return to the positive fundamentals of the Latin American economies and the enormous potential they hold.

In recent years the developing economies, in particular Latin America and Asia, have been growing faster than our largest trading partners, Western Europe and Japan. As Latin Americans have more money to spend on products and services from the United States, it seems very likely that U.S. export shares will continue to increase to this and other growing regions of the world. The Southeast can take advantage of this increased trade by focusing on products most likely to be needed by emerging market economies: capital equipment, commercial services, and consumer goods.

Through trade with the rest of the world, we can promote further growth of many of the industries that are now well established in our region as well as the development of new industries.

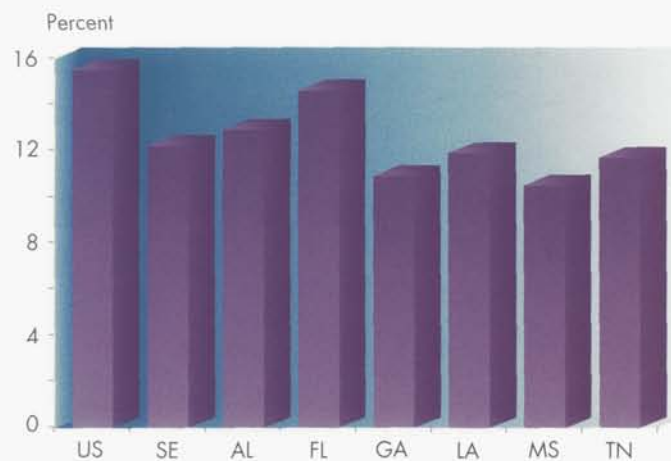
As we approach the fifth year of the economy's expansion since the 1990-91 recession, the strength of the economic recovery in much of the Southeast has cemented the reputation of the region as a full partner, if not a leader, in the national economy. In fact, this region of the country has been outperforming the United States in job growth for a number of years.

Early in the recovery, the Southeast was "fast out of the gate" thanks to the upsurge in home building throughout the nation and the region's concentration in building-related industries and durable goods manufacturing. For instance, much of the lumber, carpeting, and appliances needed to build and furnish new homes comes from the Southeast. It is in the region's interest to build on these successes and ensure that its economy continues to evolve. Looking back over the past few decades, the Southeast's growth relied heavily on attracting companies from other parts of the United States with its warmer climate, lower wages, weaker unions, and lower taxes. However, most of the firms that could make such moves have already done so, and it is time for the region to move on to new strategies for further development. Through trade with the rest of the world, we can promote further growth of many of the industries that are now well established in our region as well as the development of new industries. The happy consequence of such exports will be a greater diversification of the southeastern economy.

Looking at the larger picture, the United States as a whole has certainly benefited from increasing trade, with annual exports having more than doubled since 1984 and their contribution to gross domestic output expanding from about 7 percent in 1985 to 10 percent in 1994. We have also seen trade's effect on growth in national output by other measures. For high value-added industries such as those that manufacture capital equipment used by producers, the share of output that is exported has been growing.

The opportunity for exporting may not have been fully tapped in the Southeast in that,

Chart 4
Export-Related Manufacturing Employment as a Percentage of Total Manufacturing Employment, 1989
(The Southeast, Individual States, and the United States)



Computed by the Federal Reserve Bank of Atlanta using data in *Exports from Manufacturing Establishments, 1989*, U.S. Department of Commerce. Data for 1989 are the most recently available reliable data. State origin shares have proved relatively stable over time.

as measured by the share of jobs that is export-related, the region does some 20 percent less exporting than the United States as a whole (see Chart 4). Moreover, given that the Southeast tends to export more lower value-added products than does the nation, the region faces certain problems. For instance, exports such as bulk chemicals and some paper products put certain areas of the Southeast in the same league as a developing

nation, compared with other regions of the United States that export more high value-added items like machine tools, transportation equipment, and electronics.

Exactly how does the Southeast stand to benefit by increasing trade with Latin America? Before the depreciation of the peso in Mexico, the Southeast had significantly increased its trade of poultry and commodities to that country. Although common wisdom has it that the volume of these exports should fall off due to the depreciation of the peso, it is difficult to say whether—or to what extent—income from them will fall. Tourism has also traditionally been one of the region's "exports." Florida's theme parks, for example, export services to international visitors. Although these visitors have been primarily from Canada and western Europe, Latin Americans are the fastest-growing group of tourists visiting Florida. Another area that has been buoyed by

foreign demand is housing, particularly in Miami where Latin Americans who are doing business have been buying homes in increasing numbers.

Now that NAFTA is in place, the real question is, what should the Southeast be trading to Latin America in the future? Statistics from the Inter-American Development Bank indicate that for exports to Argentina, Brazil, Chile, and Mexico from 1990 to 1993 the fastest-growing value-added areas were construction, transportation, communications, utilities, financial services, and wholesale and retail trade. Some of these are industries in which businesses in the Southeast have a comparative advantage, and many have already begun to do more trading with Latin American countries.

CONCLUSION

The transformation of Latin America during the past decade or so has created an emerging market in the world economy. From the U.S. perspective, that development could not be more welcome because, in the long run, economic growth in Latin America will have a positive effect on the United States and the Southeast. As economic growth leads to increased incomes in Latin America, it will, in turn, lead to more trade that increases the incomes of U.S. citizens.

Similarly, the Southeastern economy has enjoyed much success in recent years, capitalizing on its strengths in producing consumer durables, bulk commodities, and certain services. The region can do better yet. First, we must foster the evolution of our labor force to prepare workers for more complex jobs whose products will meet the demands of new trading partners throughout the world. Second, we must understand that free trade with Mexico and the rest of Latin America is not a threat to our economy. Instead, it is an opportunity waiting to be captured by businesses in the Southeast. The region has been stronger than many others in the United States during this expansion, but this strength is not a reason to refrain from exploring additional avenues of growth in order to make a healthy region healthier yet.

SIXTH DISTRICT HIGHLIGHTS

FINANCIAL SERVICES

The Sixth District's commitment to quality service has remained constant in the rapidly changing environment of financial services, with primary emphases on customer satisfaction and innovation. Investments in technology and staff development made in 1994 will further enhance opportunities to improve service quality and responsiveness as well as to develop new products to anticipate customers' needs.

Check Collection. The District continued to develop innovative electronic check services to better meet the needs of the banking industry and encourage the change from paper to electronic payments. New check processing hardware and software installed in five offices will facilitate new services. (The sixth office will be converted early in 1995). The number of customers receiving electronic check data increased by 29 percent over 1993; approximately 800 customers now receive a variety of electronic check/payor bank services.

All Sixth District offices installed optical disk equipment, which provides more efficient storage and accessibility of documentation needed for research and adjustment of check-related transactions and allows staff to upgrade service to customers. This enhancement also enabled the District

to remain the System leader in the most timely resolution of adjustment cases.

Acquisition and merger activity among financial institutions within the District escalated during the year. Additionally, a number of new alliances established between depository institutions allowed the direct exchange of checks regionally and nationally. As a result, fewer interbank checks cleared through the Federal Reserve in the Sixth District and Systemwide. The District's volume of checks processed declined by 2.9 percent from 1993 levels compared with the System's average decline of 4.1 percent. However, the District continued to introduce check deposit options that offered improved credit availability at attractive prices as alternatives to customers for the clearing of checks.

Electronic Payments. By midyear the Sixth District had converted all government-only automated clearinghouse (ACH) endpoints to electronic delivery, completing the final phase of the all-electronic ACH initiative begun in 1991. The District currently has 1,500 electronic endpoints for receipt of ACH transactions and other financial information. To prepare for the implementation of FedACH, the System's centralized ACH software, the District upgraded to a national ACH customer directory, which allows easier maintenance of customer accounts. ACH commercial volume increased by 20.5 percent over 1993 levels.

In response to customer needs following the conversion to the National Dial Center—part of FEDNET, the Federal Reserve's new data communications network—staff piloted additional high-speed electronic transmissions and data compression techniques. Customers participated in Sixth District marketing research to define the requirements for Future Fedline, a new generation of the Federal Reserve's personal computer software that provides access to Fed services.

Funds transfer services volume rose by 5.3 percent over 1993. Net settlement operations were consolidated in the Atlanta office in May.

Securities/Fiscal Services. The District centralized its book-entry securities safekeeping and transfer service in the Nashville office and established a toll-free telephone number for off-line transfers and customer support. In addition to reducing costs, the consolidation has prepared the District for converting to the System's new centralized book-entry software. The District processed almost twice as many new Treasury issues than during 1993, largely because of increased interest rates during 1994.

Cash Services. In planning for the installation of a new generation of high-speed currency processing machines, staff prepared site renovation plans and formed a team to facilitate machine testing and operator training. To meet the new machines' operational requirements, staff developed a program to monitor customers' currency deposits to ensure that they comply with specified guidelines concerning physical presentment. Staff also implemented a currency and coin inventory management plan to ensure an adequate flow of cash to Sixth District customers during high-demand periods.

Financial Services Training. A new Financial Services Training Unit, located at the Jacksonville office, was formed to coordinate and support training initiatives for the District. As its first priority, the unit devel-

oped a new custody control program, to be used throughout the District, that presents a video and case studies for group instruction and interactive computer-assisted training for individual, job-specific instruction. The program can be applied to all high-security operations, such as cash, coin, and securities. The unit also planned training programs that will focus on computer data security and related technical training and various aspects of check processing.

Financial Services Management. The Sixth District's First Vice President was selected to chair the new Systemwide Financial Services Management Committee, which will provide a new management structure for overseeing check, ACH, wire transfer, cash, and securities services, as well as business development, automation, and accounting support functions. The new structure, effective January 1, 1995, establishes four new product offices (retail, wholesale, support, cash/fiscal), each headed by the First Vice President of the host Reserve Bank. Those First Vice Presidents, along with the System's Director of Automation Resources, are also members of the new Management Committee. The committee is intended to provide a more strategic focus to Fed payments activities, to improve responsiveness to customer needs, and to bring more commonality to services and procedures across Fed Districts as the industry moves toward interstate banking and interstate branching.

SUPERVISION AND REGULATION

Supervision and Regulation. The health of the domestic banking industry continued to improve in 1994, with many banking organizations posting record earnings. Assets of state-chartered, Sixth District member banks grew 25 percent, to \$56 billion. Two new members and the acquisition

activities of existing state members contributed to this increase. Consolidated bank holding company assets in the region rose by over 9 percent, to \$261 billion in 630 top-tier companies. A notable trend in the bank holding company area is the expansion of Alabama companies, primarily into Florida.

Department staff assisted in System efforts to adapt the supervisory framework to changes resulting from two banking reform bills enacted in 1994. The Riegle-Neal Interstate Banking and Branching Efficiency Act, which provides for nationwide interstate branching within three years, is expected to have a significant effect on the industry and, in turn, the supervisory process. The Riegle Community Development and Regulatory Improvement Act contains provisions to reduce regulatory burden, including streamlined application procedures that mandate more rapid processing of certain applications.

New supervisory initiatives included increased emphasis on the sale of nondeposit investment products, such as mutual funds, and the operation of securities banking subsidiaries (known as Section 20 subsidiaries). The department selected several staff members to act as capital markets contacts, working with other Federal Reserve System contacts to ensure the Atlanta Bank maintains sufficient resources to supervise capital markets activities, including the development and use of derivative instruments, and to respond promptly to changes and developments in financial markets in Sixth District organizations. The department also targeted a group of examiners to receive specialized, intensive capital markets training.

Staff in the international area had examination responsibility for more than \$43 billion in assets and contingencies at Sixth District offices of foreign banks. Staff devoted significant time to managing situations that arose because of economic and political events in Venezuela. These events led to government intervention in a number of Venezuelan banks, which in turn affected

the Sixth District operations of Venezuelan-controlled commercial banks, Edge Act corporations, and agencies.

Passage of the Foreign Bank Supervision Enhancement Act in 1991 expanded the Federal Reserve's supervision of foreign banks operating in the United States to include direct authority over the U.S. activities of these institutions. As a result, the Board of Governors has adopted an enhanced supervisory program that calls for more comprehensive consideration of home country markets, supervisory programs, accounting standards, and analysis of the parent bank's financial condition. Under the new program, Atlanta is responsible for most Latin American and Caribbean banks with U.S. operations. The Atlanta Bank directly supervises twenty-nine institutions and shares supervision of another twenty-five, based in Argentina, Brazil, and Mexico, with the New York and Dallas Federal Reserve Banks. The research division is assisting in the economic review of home country markets.

Consumer and Community Affairs.

Early in the year the Federal Reserve Board, along with nine other federal agencies, released a policy statement defining lending discrimination and establishing a foundation for interpreting bank performance. To aid in the supervision of fair lending laws, Reserve Banks adopted a new model for use in consumer affairs examinations. This model efficiently identifies application files for review for potential discrimination.

The staff continued to provide educational materials for the banking industry and community groups on consumer protection regulations and reinvestment opportunities. Education efforts included five conferences on Community Reinvestment Act/Fair Lending Act issues, eight community development lending conferences and workshops, five community assessment reports, and publication of a periodic newsletter.

Discount and Credit. Representatives from the Atlanta Fed participated with other Federal Reserve System personnel in developing a new technique for valuing collateral held as security for discount window advances, for payments system overdraft risk, and for Treasury tax and loan pledges. This new methodology, which considers market information for collateral instruments with reliable and active markets, will be first implemented with securities held in definitive form in early 1995.

The discount rate was increased three times during 1994—on May 17, August 18, and November 16—from 3.0 percent at the beginning of the year to 4.75 percent at year's end.

RESEARCH

Research. Department staff prepared studies of the U.S. and international economies to support the Bank's monetary and financial policy responsibilities and to help inform policymakers, the public, and economic professionals about monetary and financial policy issues.

The department intensified its outreach to professionals and the public through several means. Economists published articles on or related to policy issues in academic journals as well as in the Bank's *Economic Review* and its working paper series. Staff members reached the business and financial community by making speeches and contributing to conference programs. Through a more active program of seminars and by bringing more visiting scholars to the Bank, staff strengthened their contacts with academic economists.

Toward the department's goal of enlightening policy decisions, staff members studied a broad range of issues. Two studies dealt with monetary policy's effects on national output and its components. Another outlined a model for deriving

the long-term impacts of various taxes on growth. In an ongoing project, a sophisticated model of the interaction of monetary and fiscal policies was estimated using data for a three-decade period. Complementing these studies was a survey of attempts to use models of interest rates' term structure to project future inflation.

In the wake of recent global economic integration, department staff continued their research on international policy coordination. Two projects involved a model of the impact of market expectations on the outcome of negotiations. Another analyzed the breakup of tight exchange rate coordination in the European Monetary System.

Staff also devoted considerable attention to policy issues related to the nation's financial and payments systems. Concerns about financial derivatives motivated two studies, one that surveyed evidence on the risks faced by organizations that use derivatives and another that tested derivative valuation models. Other projects traced financial institutions' development as bearers of financial risks and considered the effect of ambiguous information on financial markets' behavior.

Two banking studies explored the reasons for and the impacts of banks' liquidity holdings. Related research argued that payments system innovations have increased the costs of inflation and proposed methods to mitigate this increase. Staff also worked on specific bank supervision issues. They found strong evidence that capital regulations, rather than market conditions, motivated banks' 1990-92 capital increases. One study reinforced doubts about the usefulness of single-period financial reports, and another suggested techniques for improving the accuracy of proposed regulatory methods of measuring banks' interest rate risk.

A group of studies exploring economic and financial development in the United States and abroad spoke to longer-term interests. One study evaluated strict financial market controls as development tools in less

developed countries (LDCs). Another applied lessons learned from LDCs to U.S. development lending proposals. A third article related private-sector finance principles to designing financing programs for state and local economic development. Another study found little evidence to support the use of income redistribution policies to enhance growth.

In view of the growing importance of Latin America in the world economy, the department created a Latin American research group to focus on economic developments in that region. The group, which is part of the macropolicy section, also contributes analysis to the supervision and regulation division to aid in their supervisory responsibilities for institutions based in Latin America and the Caribbean.

Public Affairs. The department contributed significantly to the Bank's efforts in the international arena. Working with the Florida International Bankers Association and the Beacon Council, the economic development arm of Miami/Dade County, the department organized a conference in Miami about the opportunities for trade and investment in Latin America and the Caribbean. The department also helped create and staff the Bank's new office of international relations, which coordinates visits by representatives of foreign institutions seeking to exchange information with Bank officers and staff members. During 1994 staff coordinated visits by more than 250 international guests from such institutions as the Bank of Japan, the National Bank of Poland, and the Superintendency of Banks in Peru. In addition, the department provided support for numerous speeches on international topics given by President Forrestal in the United States and several foreign countries.

Through conferences and other means, staff continued to provide the public with timely information on banking and financial markets. The third annual financial markets conference, held in Miami, focused on

derivatives. The conference attracted top-level academics and practitioners as well as press coverage from the *Wall Street Journal*, the *New York Times*, and several international financial publications. A conference on current issues in banking was held for regional bankers. The financial derivatives reader, published in December 1993, excited widespread interest in 1994, thanks in part to the department's intensive marketing efforts. Brisk sales required reprinting the reader before year's end. In a follow-up to the reader, the department sponsored an audioconference in which Bank economists discussed recent market developments in derivatives with an audience of practitioners, regulators, and academics from the United States and Canada.

Other public affairs projects focused on the southeastern economy. For instance, the department organized a joint conference with Georgia State University on school finance issues, gathering experts from around the country to debate equitable and efficient methods of financing public education. Staff redesigned the *Regional Update* newsletter to broaden its content and make its layout more accessible and appealing to readers. In addition, the department expanded its outreach to a wider audience of those involved in public policy in the Southeast, disseminating Bank research, statistics, speeches, and other information. To preserve awareness of the Bank's history, the research library completed the first phase of archiving the Atlanta Fed's oldest documents.

The department coordinated various community relations efforts. Local high schools received donations of used computer software packages and grocery receipts to help in the purchase of new computers. The community relations program also added two internships for inner-city high school students to the four existing college-student internships the Bank sponsors each year.

Statistical Reports. To address the implications of interstate banking for the System's statistical reporting efforts, Atlanta staff organized a network of liaisons at all twelve Reserve Banks to exchange information on depository institution mergers and acquisitions that cross District lines.

Analysts in the deposits reports area prepared and distributed a brochure encouraging depository institutions to use Fedline for submitting certain reports. They also hosted workshops in Atlanta, New Orleans, and Nashville to help respondents better understand the requirements of the "Report of Transaction Accounts, Other Deposits, and Vault Cash." The video *HMDA Q&A*, produced by Sixth District staff in 1993 to provide answers to the questions most frequently asked by respondents filing annual Home Mortgage Disclosure Act reports, was distributed nationally through the Board of Governors' HMDA operations unit.

The department began processing the "Quarterly Report of Credit Card Plans," a report introduced throughout the System to collect more accurate information on the full range of depository institutions' interest rate charges.

CORPORATE SERVICES

Automation Initiatives. The completion of strategic consolidation projects and the need to support a more dispersed automation environment made 1994 a year of transition, downsizing, and realignment of mainframe automation resources. The District made substantial progress in completing three major strategic initiatives: to consolidate general purpose mainframe processing at one of three Federal Reserve consolidation sites, to implement a high-speed, high-reliability communications network (FEDNET), and to develop and implement enhanced centralized business applications software.

Although the District transferred its general purpose mainframe applications to a Federal Reserve consolidation site in December 1993, staff continued to operate business applications remotely and will do so until transfer of support to the central Federal Reserve Automation Services (FRAS) staff is completed in 1995.

The FEDNET project was begun in earnest in 1994 with the deployment of branch and head office network equipment. Approximately 1,200 Fedline dial customers were converted to the new National Dial Center. Conversion of remaining leased line and computer interface customers begun late in the year is scheduled to be completed in 1995.

Developing and implementing centralized business applications software is a longer-term initiative that will be completed on an application-by-application basis. In 1994 the District converted to two major centralized accounting applications—billing (accounts receivable) and the integrated accounting system—that provide information to financial institutions. Staff also made preparations for converting to the centralized funds transfer system scheduled for completion early in 1995.

The Sixth District continues to be a leader within the Federal Reserve System in software development. Automation staff finished implementing the Federal Reserve's first major client/server application, known as PACS (Planning and Control System), within the Sixth District, converted another District, and began preparations to convert additional Districts in 1995.

Atlanta continues to be the development and support site for the Cash Automation System, which is run in all six District cash services departments and by two other Districts. Staff developed materials handling software in 1994 to interface the cash system to a mechanical automated vault operation. Atlanta also remains the central

site for development and support of Fedline communications software, the PC-based system used by financial institutions to access Federal Reserve Bank services.

Payments System Risk. Staff continued to work with financial institutions throughout the District to help them understand and react to the daylight overdraft measurement procedures that took effect in October 1993 and the pricing of daylight overdrafts, which took effect in April 1994. In addition, staff distributed the updated edition of the *Guide to the Federal Reserve's Payments System Risk Policy* published in July.

Human Resources. In 1994 the Bank's benefit costs declined for the first time in ten years because of savings realized primarily from the managed care medical plan introduced in 1993. Per capita costs for medical claims dropped by over 6 percent from the previous year. These cost reductions, along with favorable pricing among several of the District's HMOs, allowed the Bank to pass on premium decreases to the staff for the first time in recent history.

The Sixth District began to implement the Federal Reserve System's Integrated Benefits Processing System (IBPS), an on-line automated program that reduces paperwork associated with benefits processing and will eventually allow employees direct access to benefits information and transactions by telephone or computer terminal. The thrift plan benefit was the first to be implemented under IBPS.

In a special emphasis on performance management training, sessions held throughout the District focused on tools and methods of performance measurement, documentation, and counseling, as well as relevant legal issues. More than 300 management staff attended the sessions.

Other special seminars throughout the District dealt with sexual harassment and diversity issues. More than 300 managers attended the half-day seminars, which

emphasized the legal and employee relations aspects of these issues, as well as managers' responsibility to ensure a productive work environment free from offensive behavior or harassment.

AUDITING

The department began restructuring the electronic data processing auditing program beyond its primarily IBM mainframe coverage to include several local platforms and new products, such as local area networks, the client server platform, and new security products on the UNISYS platform. This restructuring included formal and on-the-job training, audit program development, and initial audits. Staff also participated in software development projects for the centralized billing and PACS applications for use by multiple Reserve Banks, implementing a new communication system, and planning for the conversion to a shared computer partition with other Reserve Banks.

A Districtwide conference for audit staff featured sessions on teamwork, best auditing practices, and personal improvement as well as a staff interchange with the Board of Directors audit committee. Speakers included a representative from the Board of Governors, Bank management, and internal audit and business professionals.

Atlanta auditing personnel assisted the Board of Governors' staff in examining and reviewing the Atlanta District and several other Reserve Banks. A directing auditor participated in a peer quality assurance review of another District's auditing department. Atlanta remained the site for the System Center for Auditor Development, which develops and facilitates training for all System auditors.

Several members of the District's auditing staff held leadership positions in the

System audit community. The general auditor became a member of the steering committee of the Conference of General Auditors. The District also supplied the chairman of the subcommittee on automation issues and the Conference of General Auditors' audit liaison to the System's Security Steering Group.

SECRETARY'S OFFICE

The Distinguished Speakers Series for 1994 featured prominent individuals who discussed important financial and economic issues. Speakers included Federal Reserve Governor Janet L. Yellen; Howard H. Baker, Jr., former U.S. senator and presidential chief of staff; John E. Mroz, president and founder, Institute for EastWest Studies; Norman Robertson, former senior vice president and chief economist, Mellon Bank, N.A.; Nohra Rey de Marulanda, manager, Economic and Social Development Department, Inter-American Development Bank; William M. Isaac, managing director and chief executive officer, Secura Group; Lawrence S. Eagleburger, senior foreign policy advisor, Baker, Worthington, Crossley, Stansberry & Woolf; and Germaine A. Hoston, professor

of political science and adjunct professor, Graduate School of International Relations and Pacific Studies, University of California.

Five distinguished international figures—Mary Robinson, the president of Ireland; Raul Granillo Ocampo, ambassador of Argentina; Juan Carlos Vignaud, consul general of Argentina; Sir Paul Newall, the lord mayor of London; and Harri Holkeri, former prime minister of Finland—spoke to audiences of Atlanta business, academic, and community leaders.

The Advisory Council on Small Business, Agriculture, and Labor met twice with President Forrestal and Atlanta Fed staff to exchange views on business and credit conditions in the region. President Forrestal also met twice with the Financial Institutions Advisory Committee, which represents commercial banks, thrifts, and credit unions, to discuss issues of interest to financial institutions.

In conjunction with his monetary policy responsibilities, President Forrestal also met periodically with leaders representing business, academic, financial, consumer, labor, and other community interests throughout the District to discuss current economic and policy-related issues.

ATLANTA BOARD OF DIRECTORS



Atlanta Directors, from left to right: (standing) André M. Rubenstein, Leo Benatar (Chairman), Victoria B. Jackson, W.H. Swain; (seated) J. Thomas Holton, Hugh M. Brown (Deputy Chairman), Dan E. Sweat, Jr., James B. Williams. Not pictured: D. Paul Jones, Jr.

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University of Tennessee
Knoxville, Tennessee

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Brentwood National Bank
Brentwood, Tennessee

WILLIAM BAXTER LEE III
Chairman and President
Southeast Services Corporation
Knoxville, Tennessee

MARGUERITE W. SALLEE (resigned)
President and
Chief Executive Officer
Corporate Child Care
Management Services
Nashville, Tennessee

JOHN E. SEWARD, JR.
President and
Chief Executive Officer
The Paty Company
Piney Flats, Tennessee

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New Orleans Directors, from left to right: (standing) Victor Bussie, Angus R. Cooper II, Thomas E. Walker, Howard C. Gaines; (seated) Jo Ann Slaydon (Chairman), Kay L. Nelson. Not pictured: Lucimarian T. Roberts.

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President
Slaydon Consultants and
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President
Louisiana AFL-CIO
Baton Rouge, Louisiana

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H. TERRY SMITH*
Senior Vice President

* Management Committee

** Advisor to Management Committee



Management Committee Members, from left to right: (standing) John M. Wallace, Robert P. Forrestal, Jack Guynn, James D. Hawkins; (seated) Frederick R. Herr, W. Ronnie Caldwell, Sheila L. Tschinkel, Richard R. Oliver. Not pictured: H. Terry Smith.

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Assistant Vice President

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Assistant Branch Manager

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EDWARD B. HUGHES
Assistant Vice President

PATRICIA D. VAN DE GRAAF
Assistant Vice President

STATEMENT OF CONDITION

ASSETS	DECEMBER 31, 1993	DECEMBER 31, 1994
Gold Certificate Account	\$ 509,000,000	\$ 542,000,000
Special Drawing Rights Certificate Account	318,000,000	318,000,000
Coin	55,405,739	45,574,803
Loans and Securities	13,696,686,093	16,483,759,749
Items in Process of Collection	775,094,869	752,787,239
Bank Premises	61,112,427	63,546,397
Other Assets	2,500,066,076	2,495,920,707
Interdistrict Settlement Account	2,185,366,572	1,871,481,484
Total Assets	<u>\$ 20,100,731,776</u>	<u>\$ 22,573,070,379</u>
LIABILITIES		
Federal Reserve Notes	\$ 14,959,906,004	\$ 18,053,464,412
Deposits*	3,632,354,668	3,060,140,470
Deferred Credit Items	736,272,042	560,843,139
Other Liabilities	132,352,262	216,588,158
Total Liabilities	<u>\$ 19,460,884,976</u>	<u>\$ 21,891,036,179</u>
CAPITAL ACCOUNTS		
Capital Paid In	\$ 319,923,400	\$ 341,017,100
Surplus	319,923,400	341,017,100
Total Capital Accounts	<u>\$ 639,846,800</u>	<u>\$ 682,034,200</u>
Total Liabilities and Capital Accounts	<u>\$ 20,100,731,776</u>	<u>\$ 22,573,070,379</u>

*Includes depository institution accounts, collected funds due to other Federal Reserve Banks, U.S. Treasurer-General account, other and miscellaneous deposits

STATEMENT OF EARNINGS AND EXPENSES

EARNINGS AND EXPENSES	DECEMBER 31, 1993	DECEMBER 31, 1994
Current Income	\$ 861,700,654	\$ 1,017,405,326
Current Expenses	155,047,176	163,466,743
Cost of Earnings Credits	8,436,000	12,822,589
Current Net Income	\$ 698,217,478	\$ 841,115,994
Net Additions (Deductions)*	(18,793,851)	226,366,495
Assessment for Expenses of Board of Governors	13,209,600	13,789,600
Federal Reserve Currency Cost	16,958,398	16,015,448
Cost of Unreimbursed Treasury Services	3,084,435	3,400,380
Net Income before Payment to U.S. Treasury	\$ 646,171,194	\$ 1,034,277,061
DISTRIBUTION OF NET EARNINGS		
Dividends Paid	\$ 18,375,321	\$ 19,776,874
Payments to U.S. Treasury**	597,512,673	993,406,487
Transferred to Surplus	30,283,200	21,093,700
Total Income Distributed	\$ 646,171,194	\$ 1,034,277,061
SURPLUS ACCOUNT		
Surplus January 1	\$ 289,640,200	\$ 319,923,400
Surplus December 31	\$ 319,923,400	\$ 341,017,100

*Includes gains/losses on sales of U.S. government securities and foreign exchange transactions

**Interest on Federal Reserve Notes

SUMMARY OF OPERATIONS

SERVICES TO DEPOSITORY INSTITUTIONS	1993		1994	
	ITEMS (THOUSANDS)	PERCENT CHANGE FROM ONE YEAR AGO	ITEMS (THOUSANDS)	PERCENT CHANGE FROM ONE YEAR AGO
Check Clearing				
U.S. Government Checks Processed	66,783	-1.9	65,783	-1.5
Commercial Checks Processed	3,017,041	0.03	2,930,096	-2.9
Electronic Payments				
ACH Commercial Payments Processed	280,587	20.5	338,087	20.5
ACH Government Payments Processed	76,880	3.0	80,858	5.2
Wire Transfers of Funds	10,185	2.4	10,728	5.3
Cash Services				
Currency Orders Processed	98	0	98	0
Coin Orders Processed	51	2.8	51	0
Loans to Depository Institutions*	808	-31.9	968	19.8
Securities Services				
On-Line Bookentry Transfers	47	-16.8	45	-3.3
Noncash Items Processed	363	-21.0	237	-34.7
SERVICES TO THE U.S. TREASURY				
U.S. Savings Bonds Issued	5,794	-1.4	5,743	-0.9
U.S. Savings Bonds Redeemed	59	-25.5	47	-19.6
Other Treasury Issues				
Issued	38	-23.0	75	99.2
Redeemed	3	0	3	0
Deposits to Treasury Tax and Loan Accounts	815	10.4	964	18.3
Food Coupons Destroyed	695,200	-7.1	703,722	1.2

*Numbers shown are actual, not thousands

Federal Reserve Bank of Atlanta

Head Office and Atlanta Branch

104 Marietta Street, N.W.
Atlanta, Georgia 30303-2713

Birmingham Branch

1801 Fifth Avenue, North
Birmingham, Alabama 35203-2104

Jacksonville Branch

800 West Water Street
Jacksonville, Florida 32204-1616

Miami Branch

9100 N.W. 36th Street
Miami, Florida 33178-2425

Nashville Branch

301 Eighth Avenue, North
Nashville, Tennessee 37203-4407

New Orleans Branch

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