Federal Reserve Bank of Dallas

1985 Annual Report

The Federal Reserve Bank of Dallas, which is one of 12 regional Federal Reserve Banks in the United States, serves the Eleventh Federal Reserve District. The Eleventh District, which encompasses approximately 363,000 square miles, is composed of the State of Texas, Northern Louisiana and Southern New Mexico. There are three branch offices of the Federal Reserve Bank of Dallas located in El Paso, Houston and San Antonio.

The Federal Reserve System is the central banking system of the United States with the basic purpose of providing a flow of money and credit that will foster orderly economic growth and a stable dollar. In addition to this major function, Federal Reserve Banks issue Federal Reserve notes and hold deposits of and make loans to financial institutions, act as Fiscal Agent for the United States, regulate and supervise banks, and assemble, analyze, and distribute economic and banking data.

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MESSAGE FROM THE CHAIRMAN AND THE PRESIDENT

While the nation as a whole continued to enjoy a rebounding economy in 1985, the economic growth in the Eleventh Federal Reserve District was substantially slower. Much of this can be attributed to the sluggish energy industry; and a message came through loud and clear at a Dallas Fed-sponsored conference in October that at least for the next couple of years, things probably won't improve in this sector. The expectation for lower oil prices will continue to depress spending for exploration and that will suppress prices for drilling services and equipment. Problems in agriculture in this District, while not as severe as in the Midwest, also contributed to the slower economic growth here. This past year also saw a significant slackening in the semiconductor industry. Intensified foreign competition in industries such as energy, electronics, and lumber has adversely impacted the economy as well. A sign of the times is the Texas unemployment rate. Historically, it has been much lower than the national rate, but in 1985 it was at about the same level as for the country as a whole.

Despite the energy industry's continued weakness, growth in the service sector made a considerable contribution to the District

economy in 1985. The significance of service employment in the Texas economy during recent years is the subject of the principal article in this year's annual report.

On the subject of service, we at the Federal Reserve Bank of Dallas worked hard this past year to improve the services we provide financial institutions in this District. A number of these developments and enhancements are described in the Review section of this report. We promise you that our dedication and commitment as your central bank will continue to grow in the new year.

We have truly enjoyed working with the financial institutions and community organizations in the Eleventh District during 1985, and we look forward to learning your views and suggestions in 1986. Together, we will strive for economic stability and a productive financial climate that will best serve all elements of our society.

Sincerely,

Robert D. Rogers
Chairman of the Board

Robert H. Boykin
President

Robert D. Rogers, left, and Robert H. Boykin

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THE GROWTH OF SERVICES IN THE TEXAS ECONOMY

Services have played an important role in the recent growth of the Texas economy. Of the 2.5 million jobs created in the state from 1972 through 1984, 1.8 million were in service-producing industries. Here we review the facts concerning service growth in the state of Texas, outline the underlying reasons for that growth, and discuss its consequences for the Texas economy.

In the last fifteen years, service employment has increased at a faster pace in Texas than it has in the nation. Growth in Texas' energy industry accounts for one-fifth of the growth in the state's service industries. During the 1970s, Texas' service growth would have been on a par with that nationwide had energy employment in the state not increased. Since 1980, however, the gains in service employment that are unrelated to energy have allowed services to grow more rapidly in Texas than in the nation.

Service industries are absorbing an ever-increasing share of the Texas labor force. Contrary to some popular opinion, the shift toward services will do little to alter the size of the middle income class in Texas. But the service shift should make the state less sensitive to the

business cycle, because services cannot be stored and thus are less vulnerable to large swings in demand. On a more human note, the direct contact between consumer and worker that occurs frequently in service occupations may also help to create more satisfying job experiences for Texas workers.

Services defined. Two definitions of services are used in our discussion. The more narrow one—referred to as "services"—includes finance, insurance, real estate, hotels, personal services, business services, repair, entertainment, health, and education. The broader definition—referred to as "service-producing"—includes wholesale trade, retail trade, and government, as well as the more narrowly defined service category. Each definition covers a wide variety of industries. As a general rule, though, the industries included produce an intangible product, are labor-intensive, and involve direct contact with the consumer.

WHAT ARE THE FACTS?

Historical background. The rapid growth of services has been pervasive, across both time and space. The share of total U.S. employment accounted for by service-producing industries has been rising since at least 1870. This same trend is present in virtually all states of the nation and in all industrialized countries of the world. How the composition of employment in Texas and the

nation has changed since 1940 is shown in Table 1.

Each economy is divided into three major sectors: the agricultural sector, a service-producing sector, and a goods-producing sector consisting of mining, construction, manufacturing, and transportation and public utilities. Evident for both Texas and the United States are a steady decline in agriculture's share of employment and a steady rise in the share attributable to service-producing industries. Though the share of the goods sector initially rises, it then declines. Interestingly, while Texas in 1940 had a relatively large agricultural sector and a relatively small goods sector, by 1984 the sectoral distributions of employment in Texas and the nation had become identical.

Table 1
COMPOSITION OF TEXAS AND U.S. EMPLOYMENT, 1940-1984

Employment by sector	1940	1950	1960	1970	1984[a]
	Percent of total				
Texas					
Agriculture	32	16	9	5	3
Goods-producing	25	34	36	35	34
Service-producing	43	50	55	60	63
Total	100	100	100	100	100
United States					
Agriculture	19	12	7	4	3
Goods-producing	37	42	41	39	34
Service-producing	44	46	52	57	63
Total	100	100	100	100	100

[a]Estimated.
SOURCE OF PRIMARY DATA: U.S. Bureau of the Census, *Census of Population.*

Prior to 1960, the employment shift to services was due primarily to a decline in the importance of agriculture. Both the service sector and the goods sector became more important sources of employment, and no persistent tendency emerged, either in Texas or nationally, for service employment to rise more rapidly than goods employment. After 1960, however, agriculture's share of employment began to stabilize at a low level. Further increases in service's share were associated with a decline in the share related to goods-producing industries.

Recent growth of service industries. In Texas, service industries have grown rapidly over recent years. During the period 1972–1984, Texas employment in the narrowly defined service category increased at an average annual rate of 5.7 percent. This compares favorably with the national economy in which, during the same period, service employment increased at a rate of 4.2 percent per year. In relation to other Sunbelt states, Texas has neither moved ahead nor lagged behind (see Chart 1). During the 1970s, no significant difference developed between the growth rates of service employment in Texas and two other prominent Sunbelt states, California and Florida. Since 1980, however, service employment has increased somewhat more quickly in Florida but somewhat less so in California.

Chart 1

Service Employment Growth, 1972–1984

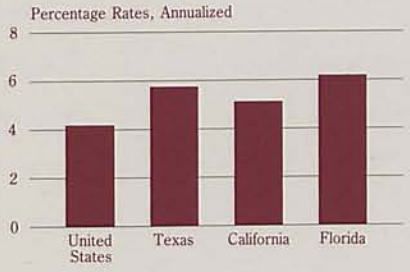


Table 2 reflects how fast individual service industries have increased over the past ten years. In both Texas and the United States, employment has grown most rapidly in the professional and business services. Texas has outdistanced the United States in virtually all service industries, with the greatest margins occurring in accounting, engineering and architecture, and insurance and real estate. Also shown in Table 2 are the mean annual wages of service employees. As is clear from these figures, the fastest-growing service

Table 2
SERVICE EMPLOYMENT GROWTH IN TEXAS AND THE UNITED STATES, 1975–1984

Industry	Annualized growth rates: Texas	Annualized growth rates: United States	Mean annual wages[a]
	Percent		Dollars
Computers and data processing	15.0	14.5	25,700
Management consultants	12.6	10.5	25,600
Legal services	10.1	7.2	26,100
Accounting	9.7	5.9	21,700
Engineering and architecture	9.1	5.6	28,100
Business services	9.1	6.3	13,800
Social services	6.9	7.8	9,700
Banking and credit	6.4	3.5	18,400
Insurance and real estate	6.4	3.0	19,200
Hotels	5.8	3.8	9,800
Health care	5.2	4.5	17,900
Education	4.9	5.0	15,400
Repair	4.9	4.4	15,600
Entertainment	4.4	2.9	13,300
Personal services	3.4	2.0	9,800

[a]Based on national data for 1984.
SOURCE OF PRIMARY DATA: U.S. Bureau of Labor Statistics, *Employment and Wages.*

industries are also the ones with the highest average wages.

Present composition of service employment. The current importance of individual service industries to total service employment in Texas is shown in Table 3. The industries that account for the largest shares of service employment are education, health care, business services, insurance and real estate, and the professional services. In the last column of Table 3, the composition of Texas service employment is compared with that of the United States. The figures indicate, for example, that the share of service employment accounted for by insurance and real estate is 21 percent larger in Texas than it is in the nation. Firms selling financial and business-related services generally are a more important source of service employment for Texas than they are for the nation, whereas health and entertainment are less important to the state.

Table 3
COMPOSITION OF SERVICE EMPLOYMENT IN TEXAS AND THE UNITED STATES, 1984

Industry	Texas	United States	Texas/United States times 100
	Percent of total		
Insurance and real estate ...	10.2	8.4	121
Professional services[a]	9.0	7.9	114
Business services	10.3	9.1	113
Personal services	3.4	3.1	110
Repair	3.2	3.0	107
Social services[b]	4.4	4.2	105
Education[b]	23.4	22.3	105
Banking and credit	7.4	7.1	104
Hotels	3.8	3.9	97
Health[b]	19.2	22.5	85
Entertaiment	2.3	3.2	72
Other	3.4	5.3	64
Total	100.0	100.0	100

[a]Includes computer and data processing personnel, management consultants, and all workers employed by legal, engineering, and accounting firms.
[b]Includes government employees.
SOURCE OF PRIMARY DATA: U.S. Bureau of Labor Statistics, *Employment and Wages.*

WHY THE SHIFT TOWARD SERVICE EMPLOYMENT?

Agriculture declines in importance. The percentages of Texas and U.S. employment that are accounted for by service industries have been increasing throughout the twentieth century. But for much of this period, as noted earlier,

the growing importance of service employment was largely a reflection of the declining importance of agricultural employment. Paradoxically, agriculture's decline is best explained by its success. Improvements in agricultural technology have reduced dramatically the amount of labor required in farm production. In addition, agriculture's share of total employment has fallen because agricultural products have accounted for a declining share of consumer expenditures. Households have elected to spend a smaller and smaller fraction of their incomes on food as economic growth has raised per capita income.

More recently, service industries have absorbed an increasing share of nonagricultural employment. Employment in goods-producing industries has lagged behind service employment. When turned upside down, the two factors responsible for agriculture's declining share of employment also explain this recent increase in service's share of employment. Service employment has grown rapidly because service products have absorbed an increasing percentage of household and business expenditures and because labor productivity has advanced more slowly in the service sector than in the goods-producing sector.

Consumers demand more services. Consumers are spending an increasing proportion of their incomes on services. Because the demand for services is positively related to education, this

partly reflects a better-educated population. In the last two decades, the average level of educational attainment in the United States has risen significantly. The more prominent role of women in the work force also seems to have encouraged service expenditures. The share of household expenditures going to services increases by about 10 percent when a wife enters paid employment. For example, the household with a working wife typically spends a larger fraction of its income on restaurant meals and child care services.

In more recent years, consumer demand in the United States has been heavily influenced by the high international value of the dollar. When the dollar rises in value, U.S. consumers are encouraged to divert their expenditures away from home-produced goods and toward foreign goods. Service industries generally face less foreign competition than do industries such as manufacturing. Consequently, the appreciation of the dollar has altered the composition of domestic production in favor of items that are not widely traded, with services being an important example.

Producers demand more services. The relative increase in the demand for services is also attributable to business organizations. With smaller firms consolidating into larger units and with product lines more diverse, the tasks of corporate executives have become more complex. These developments have sharply

escalated the demand for financial and management consulting services. The rapid growth in government regulations during the 1960s and 1970s also increased the need for accountants and lawyers. It is no coincidence that the highest rates of growth in service employment over the last decade have been in the professional and business services. The stronger need for these services is evident not only in the rise of independent service organizations, but also in the composition of general industry employment. For example, the percentage of manufacturing employees who are directly involved with production has declined by 5 percentage points since 1967.

Labor productivity rises less rapidly in the service sector. The shift toward services is more evident in employment than in output. Since 1967, the share of real gross national product accounted for by service-producing industries has risen by 9 percent. Service's share of national employment, on the other hand, has increased by 17 percent. From these figures, it is clear that labor productivity has not increased as rapidly among service-producing industries as among goods-producing industries. The increasing frequency with which workers are employed by service industries is not simply a reflection of changes in the composition of output. It is also a result of the success goods-producing industries have had in economizing on labor.

It is difficult to pin down the reasons for the

productivity gap. Some of it ultimately may stem from the shifts in consumer and producer demand noted earlier. Since service industries are labor-intensive, the shift in national output toward services has contributed to an economy-wide increase in the cost of labor. This, in turn, has raised labor productivity by encouraging all industries to reduce the labor content of their product. If goods industries were more technologically adept at economizing on labor, this would explain the more rapid advance of labor productivity in the goods sector. But it is likely that other factors also have been involved. For example, because of unions and minimum wage legislation, the price of labor has risen more quickly in the goods sector. Because goods-producing firms have had stronger incentives for labor economy, this could account for their relative success in raising labor productivity.

Energy has contributed to service growth in Texas. During the period 1972–1984, employment in Texas service-producing industries increased at an annual rate of 4.7 percent, while U.S. service-producing employment rose at a significantly slower rate of 2.8 percent. Because this was also a time when Texas experienced enormous growth in its oil and gas industry, it would not be surprising for some of Texas' service-industry development to be related to the growth in its energy industry. The discussion in Box A ex-

Box A:
Energy and Texas Employment

By using an input-output table, it is possible to determine the importance of the energy industry to the overall level of employment in Texas. This table is used to calculate the effect of adding one worker in each of three energy-related industries—oil and gas extraction, oilfield machinery, and oil refining—on employment in each of the other industries in the state. The effects include, for example, not only the financial and professional services that are purchased directly by energy firms, but also the employment generated when a rise in state personal income increases the demand for restaurants, auto repair shops, movie theaters, and other service-related industries. The total impact of Texas energy growth on employment in any given industry is obtained by first multiplying the marginal effect of additional energy employment by the actual gain in energy employment that has taken place since 1972, and then adding up the effects associated with each of the three energy industries. The results of these calculations are summarized in Table A.

Private nonagricultural employment in Texas rose some 2.2 million workers during the period 1972–1984. Of these, 0.6 million can be accounted for by the rise in employment in the state's energy industry. Without this growth, total employment would have risen at an annual rate of 3.5 percent rather than the 4.5 percent actually recorded. When broken down by sector, energy growth was responsible for 21 percent of the rise in manufacturing employment, 22 percent of the employment gains in wholesale and retail trade, and 19 percent of the increase in service employment.

Table A
IMPORTANCE OF ENERGY TO TEXAS EMPLOYMENT GROWTH, 1972–1984

	Changes in employment		Annualized growth rates		
			Texas		
Sector	Actual	Energy-related	Actual	Without energy	United States
	Thousands		Percent		
Manufacturing	258	54	2.5	2.1	0.1
Wholesale and retail trade	669	147	4.6	3.7	2.8
Services	814	154	5.7	4.9	4.2
Other[a]	444	203	4.6	2.7	1.2
Total private nonagricultural employment	2,185	558	4.5	3.5	2.2

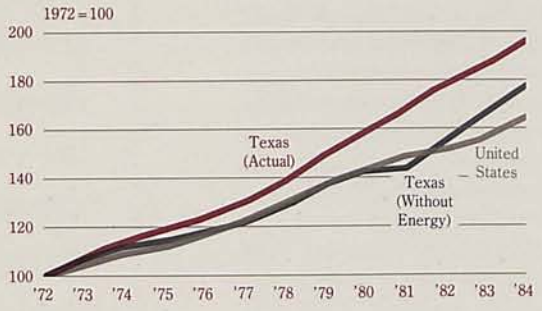
[a]Includes mining, construction, and transportation and public utilities.
SOURCES OF PRIMARY DATA: U.S. Bureau of Labor Statistics, *Employment and Earnings*. Federal Reserve Bank of Dallas.

plains how it is possible to evaluate the importance of the energy industry to Texas employment growth.

From 1972 through 1984, growth in three energy-related industries—oil and gas extraction, petroleum refining, and oilfield machinery—contributed almost a full percentage point to the growth rate of Texas service employment. The largest job gains attributable to energy were in retail trade (122,000), financial services (38,000), health care (30,000), wholesale trade (28,000), and professional and business services (25,000).

Chart 2

Effect of Energy Growth on Texas Service Employment, 1972–1984



A year-by-year account of the effect of energy growth on Texas service employment is provided in Chart 2. During the period 1972–1980, service employment growth in Texas would have been on a par with that in the nation had employment in the state's energy industry remained at its 1972 level. Since 1980, however, service employment gains unrelated to energy have been sufficient to allow service growth to proceed more rapidly in Texas than in the nation.

Manufacturing growth increases service employment in Texas. Regardless of whether it was caused by differences in wages, union strength, or climate, manufacturing has migrated away from the North and Northeast towards the South and Southwest. Over the period 1972–1984, U.S. manufacturing employment crept upwards at an annual rate of 0.1 percent.

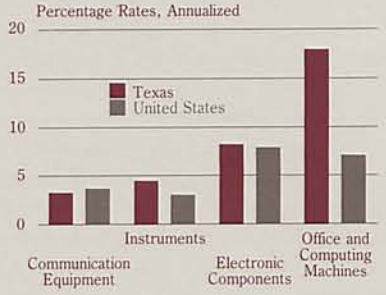
Box B:
Linkages between Services and High Technology

As a rule, service industries have grown more rapidly than goods-producing industries. An important exception, however, has been in the high-technology area. Industries that produce office and computing machines, electric and electronic equipment, and various instruments and measuring devices have grown faster than manufacturing as a whole and, in some cases, faster than most service industries. Chart A shows how rapidly Texas employment in some high-tech industries has grown over the past ten years.

It is not a coincidence that services and high technology have grown together. Much of their growth is a reflection of the same underlying changes in the type of

Chart A

Employment Growth in High-Tech Industries, 1975–1984



Manufacturing employment in Texas, on the other hand, increased at a rate of 2.5 percent per year. Other Sunbelt states, such as California and Florida, also experienced rapid manufacturing growth.

The growth of manufacturing in Texas contributed to the growth of its service industries. As the manufacturing work force grew, so did the demand for consumer services such as real estate, education, and health care. And the manufacturing firms themselves, particularly those in the high-technology area, supported many new professional and business service companies. The relationship between services and high technology is further detailed in Box B.

WHAT ARE THE CONSEQUENCES?

Service growth preserves middle income class. Some commentators have argued that service industries have a large proportion of high- and low-paying jobs, but a relatively small proportion of jobs in the middle of the earnings structure. Will Texas lose its middle income class because of the shift toward service employment? Data on earnings by occupational group show that the distribution of individual earnings in the United States did tend to polarize over the period 1958–1977 and that the shift in employment toward service-producing industries was largely responsible for that trend. More recent research, however, indicates that this trend slowed considerably during the period 1973–1977

and that since 1977 it has been reversing.

In a study conducted at the Bureau of Labor Statistics, 1982 data on weekly earnings were used to arrange a large number of detailed occupations into three groups—bottom, middle, and top—with each group containing the same number of occupations.[1] From 1973 through 1982, the proportion of U.S. workers employed in the lowest-paid group fell 2.0 percentage points. The proportion employed in the highest-paid group, on the other hand, rose 2.7 percentage points. The middle group experienced very little change.

The distribution of family earnings has continued to polarize in recent years. But this is a result of the growing number of two-income households, not the shift toward service employment. In sum, the available evidence lends no support to the fear that the recent shift toward service employment has eroded the size of the middle income class in Texas. The change that did take place was probably favorable, with a greater percentage of workers moving into high-paying jobs and a smaller percentage being confined to low-paying jobs.

Economy becomes less sensitive to the business cycle. The rapid growth of services should make the Texas economy less sensitive to the business cycle. Because services cannot be stored, this sector avoids the swings in output that result from changes in the rate at which inventories are accumulated or reduced. Employ-

work being done. For example, in relation to other manufacturers in the state, Texas high-tech firms employ almost twice as many professional and technical workers. These include managers, engineers, architects, computer scientists, mechanics, and electrical repairmen—workers who perform many of the same job tasks carried out in the fastest-growing service industries. By the same token, a relatively small percentage of high-tech employees are directly involved with production. Thus, the implication is that much of the activity in high technology is service-oriented work that is simply being done within a manufacturing organization.

Other economic relationships between high technology and services include, for example, a strong complementarity between the computer industry and many of the business and professional service industries. Technological advances made in microelectronics and computer hardware not only expand their share of manufacturing activity, but also lower the price of information and consulting services. This contributes to the rapid growth of independent companies supplying data processing and management consulting services.

The high-tech sector is closely linked also to education. High-tech firms employ a relatively large number of workers with college and postgraduate degrees. As a result, they tend to locate in areas with superior educational facilities. Once established, they promote further growth in area schools and colleges by continuing to supply a large number of jobs to workers with high levels of education.

1. Neal H. Rosenthal, "The Shrinking Middle Class: Myth or Reality?" *Monthly Labor Review*, 108 (March 1985): 3-10.

ment stability is further encouraged by the relative insignificance of unions to the service sector and by the large number of service workers who are self-employed. Because service workers are less organized, their wages are more flexible, and shifts in demand have less of an impact on hours worked. Whatever the reasons, after accounting for trends, the average change in national employment over the business cycles of the post-World War II period has been 12 percent for goods-producing industries but only 3 percent for service industries.

Industry structure is more competitive. The increasing importance of service industries will raise the overall level of competition among firms. Much of the production in the goods sector takes place in large corporations. Over 40 percent of the workers in manufacturing, for example, are employed by firms with more than 500 employees. These large firms frequently control sizeable fractions of their markets. In the service sector, on the other hand, firms are typically small, with only 22 percent of service employees working for firms with more than 500 employees.

Service work is more personal. As society moved away from crafts and toward mass production, it was thought that work was growing impersonal and that workers were becoming too far removed from the finished product. The rapid increase in service employment is reversing that

trend. Many service industry employees are now engaging in a highly personalized activity. The direct contact between consumer and worker that occurs frequently in service occupations should help to create more satisfying job experiences for Texas workers.

CONCLUSION

The shift toward services that is occurring in both Texas and the nation is partly a consequence of individual economic sovereignty. As per capita incomes have risen, consumers have elected to spend a greater percentage of their incomes on health care and education. And as more women have decided to enter the labor force, independent service companies have emerged to supply many of the services originally provided in the home.

Much of the growth in services also reflects an ongoing struggle for greater efficiency in business organization. As the economies of the world have become more interdependent and as the pace of technological change has quickened, the demands on business management have grown enormously. Businesses have come to rely more and more on independent firms for legal, accounting, financial, and consulting services. The growth of these specialized business service companies has increased production efficiency, with benefits accruing to individuals throughout the Eleventh Federal Reserve District.

1985 IN REVIEW

NEW ADVISORY COUNCILS

The Federal Reserve Bank of Dallas formed two new advisory councils in 1985. One is the Advisory Council of Financial Institutions, chaired by A. W. Riter, Jr., Chairman and Chief Executive Officer of InterFirst Bank Tyler, N.A. The other is the Advisory Council of Small Business and Agriculture, headed by J. Wayland Bennett, the Charles C. Thompson Professor of Agricultural Finance and Associate Dean of the College of Agricultural Sciences at Texas Tech University in Lubbock.

Each of the 12 Federal Reserve Banks has established one or more advisory councils for small business, agriculture, financial institutions, and other groups, depending on existing arrangements and economic characteristics of their respective Federal Reserve Districts. The purpose of these councils is to provide Reserve Banks with information useful in their analysis, evaluation, and research of regional and national economic activity, and business and banking conditions. The councils in the Eleventh District meet at least twice a year with senior management of the Dallas Fed. The council chairmen meet annually with the Federal Reserve Board of Governors in Washington, D.C.

Serving on the Advisory Council of Financial Institutions are William E. Brady, President, Denton Savings, Denton, Tex.; Kenneth L. Burgess, Vice Chairman of the Board, First State Bank, Abilene, Tex.; Paul Mitchell, President, Food Industries Credit Union, Houston, Tex.; Gary Owen, President, First Federal Savings Bank of New Mexico, Roswell, N. Mex.; Ronald Brown, Chairman and Chief Executive Officer, RepublicBank Houston, Houston, Tex.; H. O. Bursum, III, Chief Executive Officer and Executive Vice President, First State Bank, Socorro, N. Mex.; Marvin H. Hancock, Jr., President and Chief Executive Officer, Capital Bank, Dallas, Tex.; T. D. Wallace, President, Louisiana Credit Union League, Shreveport, La.; James A. Altick, President and Chief Executive Officer, Central Bank, Monroe, La.; John H. Dalton, Chairman and Chief Executive Officer, Freedom Capital Corporation, San Antonio, Tex.; and Charles T. Doyle, Chairman and President, Texas Independent Bancshares, Texas City, Tex.

Members of the Advisory Council of Small Business and Agriculture are Robert M. Carter, Farmer, Plainview, Tex.; John O. Chapman, Rancher, Corpus Christi, Tex.; Lloyd E. Cline, Farmer, Lamesa, Tex.; Sharon Jobe, Chief Financial Officer, TCP Industries, Inc., Dallas, Tex.; Carolyn Draper, President, 3-D Distribution Systems, Inc., Dallas, Tex.; Robert W. Philip, Partner, Arthur Andersen & Co., Dallas, Tex.; Dan Pustejovsky, Farmer, Hillsboro,

Tex.; James Washington, President, Focus Communications Group, Dallas, Tex.; J. B. Cooper, Farmer, Roscoe, Tex.; William P. Stephens, Director, New Mexico Department of Agriculture, Las Cruces, N. Mex.; and Carlos A. Zuniga, Owner, Laredo Freight Services, Inc., Laredo, Tex.

The Federal Reserve Bank of Dallas is very pleased to have these distinguished business leaders serving on the advisory councils for the Eleventh District.

FINANCIAL SERVICES

Much of the Dallas Fed's energies during the past year were directed at providing the best service possible to financial institutions throughout the Eleventh District. The Bank developed and refined several products to meet the continually changing needs of the financial community in a deregulated environment. Significant progress continues to be made in offering services electronically, where practical, to provide more efficient and accurate service.

Customer Assistance. The new year was ushered in with a new unit—the Customer Assistance Group—in the Dallas Fed's Corporate Banking Department. The group was established initially to aid financial institutions connected to the Dallas Fed through the Bank's RESPONSE network and to assist those wanting to join the network. The group handles

questions about access to the network and use of the various service applications available. In addition, the group coordinates the resolution of hardware or communication problems to ensure a prompt solution. Users now have a single contact point for obtaining fast and courteous assistance.

The group also serves as a liaison between operations areas and financial institutions in the development of new RESPONSE applications in order to maintain consistency and ensure easy use by network participants. Assistance continues to be provided to institutions in the installation of equipment and training in the use of the network.

The introduction of the Customer Assistance Group is another example of the Bank's continuing efforts to update the network and to provide quality services to those connected with it. Throughout 1986, the Dallas Fed plans to expand the Customer Assistance Group to centrally monitor and resolve customer inquiries and problems in financial service areas such as cash, checks, securities, and transfer of funds.

RESPONSE Network. The RESPONSE network is the communications link connecting financial institutions with the Dallas Fed computer and the nationwide Federal Reserve communications system. RESPONSE now includes over 850 depository financial institutions in the Eleventh District, each having instant access to electronic receipt or transmission of vital data,

information, and instructions. In 1985, the Dallas Fed began allowing RESPONSE participants to purchase equipment immediately, while formerly they had to lease it from the Bank for at least one year. Enhancements also were introduced during the year. Several modifications to the dial-up portion of the network were phased in as part of a nationwide Federal Reserve automation program. New applications software was introduced to further broaden the capabilities of the RESPONSE network. Data transmission speeds were doubled, and a new access control system was implemented to increase data security. Another RESPONSE enhancement planned is a data encrypting capability. This, plus the new access control system, will produce a more protected and efficient data security system.

The Dallas Fed further improved the RESPONSE network by offering participants the option of upgrading the computer equipment they have at their facility. Institutions leasing a microcomputer from the Dallas Fed were invited to upgrade their equipment to an internally mounted fixed disk with additional memory. All institutions were requested to maintain a certain level of memory capacity in anticipation of service enhancements to be implemented during 1986.

Electronic Services. In September, new software was installed at the Dallas Fed to process automated clearinghouse (ACH) transactions with

greater speed and accuracy than the previous software. The new software also provides a basis for additional automated devices to be added in the future. 1985 also marked the expansion of capabilities for transmitting "bulk data" to financial institutions and monitoring the quality and timeliness of the flow of information.

ACH is an electronic transfer system which allows debits and credits to be made between financial institutions without the paperwork usually associated with clearing checks.

Cash Services. A 25 percent increase in currency processing production was accomplished in mid-1985 when an extended Currency Verification Counting and Sorting shift was established at the Dallas office.

The shrink wrapping of fit currency for placement into circulation was implemented in the last quarter of 1985. Shrink wrapping provides additional security to the Reserve Bank and to financial institutions by reducing the risk of loss in shipment.

Payments Mechanism. During 1985, the Bank continued to serve as the Federal Reserve System's pilot for streamlined return item processing. In a high percentage of cases, returns are being forwarded directly to the institution of first deposit, bypassing intermediaries and thereby allowing for shortened return times.

On October 1, 1985, return item notification requirements of Regulation J were strength-

ened. In order to facilitate financial institutions' compliance, the Dallas Fed began offering a new range of notification services.

On January 2, 1985, improved availability of checks drawn on financial institutions located in Northern Louisiana became possible when the Dallas RCPC (Regional Check Processing Center) zone was expanded to incorporate that territory.

During the year, the Bank began implementation of new Transfer of Funds application software that provides for improved throughput and an increased level of security.

SEMINARS

The Dallas Fed hosted a workshop which presented information on the risks associated with investment in repurchase agreements. The workshop, held in Dallas, was attended by nearly 200 representatives of financial institutions, as well as by elected or appointed officials from cities across the Eleventh District. A repurchase agreement, or "repo," represents a money market transaction in which a security—typically a U.S. government obligation or agency issue—is sold at a specified price for a designated period of time. The contract prescribes that the security will be bought back (repurchased) at the end of the agreement's term. There was considerable concern about this type of investment instrument following two well-publicized failures of government securities dealers.

During 1985, the Federal Reserve Board introduced a voluntary program to reduce daylight overdrafts by financial institutions. To help those affected to better understand the new procedures, the Dallas Fed hosted a series of seminars on the subject in Dallas and at the branch cities of El Paso, Houston, and San Antonio. A daylight overdraft results when a financial institution moves more funds out of a reserve or clearing account at the Fed than there are in the account.

In October 1985, the Dallas Fed hosted a major two-day conference in Dallas dealing with the economy of this region and its relationship to the energy sector. Leading economists from throughout the country addressed an audience of over 150.

COMMUNITY ACTIVITIES

The Federal Reserve Board encourages the Reserve Banks to take an active role in corporate citizenship in their respective districts. The Dallas Fed takes this responsibility seriously, promoting civic and community involvement of the Bank and its staff. There are two areas in particular where the Federal Reserve feels a keen sense of obligation—in economic education and in community affairs, particularly community reinvestment activities.

Additional momentum was gained in 1985 in addressing these two important goals. New professional staff members have formulated pro-

grams which are meeting with gratifying acceptance. Many of the economic education activities are carried out in conjunction with the Texas Council on Economic Education and the Texas Agricultural Extension Service. The community affairs office seeks to become a catalyst with Eleventh District lenders, business leaders, state and local officials, and civic and community groups for development purposes. The Bank provides information on various public and private programs and works closely with other government agencies that have similar objectives. These efforts are designed to go beyond the regulatory prescriptions of the Community Reinvestment Act, which directs depository financial institutions to serve the convenience and needs of their communities.

Community involvement also is expressed in the Bank's "adoption" of the Margaret B. Henderson Elementary School in Dallas. A series of activities were again carried out during the past year to support the school and its staff. This involvement with the Henderson school stems from the Bank's participation in the Adopt-A-School program organized and operated by the Dallas Independent School District. The program encourages major businesses to "adopt" one of the DISD's schools to work with and support.

With the Texas Legislature establishing "career ladder credits" for teachers, the Dallas Chamber of Commerce teamed with the Dallas Independent School District to formulate a

unique teacher enrichment program. It involves getting leading companies in the area to sponsor one-day seminars at their places of business to explain their operations. The teachers are invited to attend seminars relevant to their classroom subjects and receive credit for this learning experience. As the Chamber's program is headed by this Bank's First Vice President, William H. Wallace, the Dallas Fed sponsored the initial teacher seminar last November.

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STATEMENT OF CONDITION

	December 31, 1985	December 31, 1984
ASSETS	(thousands)*	
Gold certificate account[1]	$ 713,000	$ 726,000
Special Drawing Rights certificate account[2]	307,000	310,000
Coin	38,639	33,894
Loans to depository institutions	18,975	22,900
Securities:		
Federal agency obligations	531,790	531,441
U.S. government securities	11,492,195	10,086,354
Total securities	$12,023,985	$10,617,795
Items in process of collection	1,359,237	814,410
Bank premises (net)	19,069	18,571
Other assets	1,101,281	1,043,736
Interdistrict settlement account	(612,062)	719,682
TOTAL ASSETS	$14,969,121	$14,306,987
LIABILITIES		
Federal Reserve notes	$11,099,711	$10,807,478
Deposits:		
Depository institutions	2,614,772	2,480,242
Foreign	12,000	11,100
Other	51,470	34,141
Total deposits	$ 2,678,242	$ 2,525,483
Deferred credit items	751,309	551,129
Other liabilities	143,436	164,304
TOTAL LIABILITIES	$14,672,699	$14,048,395
CAPITAL ACCOUNTS		
Capital paid in	$ 148,211	$ 129,296
Surplus	148,211	129,296
TOTAL CAPITAL ACCOUNTS	$ 296,423	$ 258,592
TOTAL LIABILITIES AND CAPITAL ACCOUNTS	$14,969,121	$14,306,987

*Detail figures may not balance to totals due to rounding.
[1]This Bank's share of gold certificates deposited by the U.S. Treasury with the Federal Reserve System.
[2]This Bank's share of Special Drawing Rights Certificates deposited by the U.S. Treasury with the Federal Reserve Bank of New York.

INCOME AND EXPENSES

For the year ended December 31	1985	(thousands)*	1984
CURRENT INCOME			
Interest on loans	$ 38,832		$ 72,422
Interest on government securities	1,077,764		1,081,773
Income on foreign currency	18,383		16,017
Income from priced services	44,421		40,471
All other income	1,067		914
Total current income	$1,180,468		$1,211,598
CURRENT EXPENSES			
Current operating expenses	$ 72,119		$ 65,246
Less expenses reimbursed	(4,065)		(4,491)
Current net operating expenses	$ 68,053		$ 60,755
Cost of earnings credits	4,376		4,027
Current net expenses	$ 72,429		$ 64,782
CURRENT NET INCOME	$1,108,038		$1,146,815
PROFIT AND LOSS			
Additions to current net income:			
Profit on sales of government securities (net)	$ 6,964		$ 3,211
All other additions	123,458		—
Total additions	$ 130,422		$ 3,211
Deductions from current net income:			
Loss on foreign exchange transactions (net)	$ 640		$ 33,656
All other deductions	27,351		889
Total deductions	$ 27,991		$ 34,546
Net additions or deductions	102,431		(31,335)
Assessment by Board of Governors:			
Expenditures	$ 6,177		$ 6,103
Federal Reserve currency costs	11,149		10,287
NET INCOME AVAILABLE FOR DISTRIBUTION	$1,193,142		$1,099,091
DISTRIBUTION OF NET INCOME			
Dividends paid	$ 8,360		$ 7,132
Payments to the U.S. Treasury (interest on F.R. notes)	1,165,867		1,070,312
Transferred to surplus	18,915		21,647
Surplus, January 1	129,296		107,650
Surplus, December 31	$ 148,211		$ 129,296

*Detail figures may not balance to totals due to rounding.

VOLUME OF OPERATIONS

HEAD OFFICE AND BRANCHES COMBINED

	Number of Pieces Handled		Dollar Amount (thousands)	
	1985	1984	1985	1984
Currency received and counted	797,200,000	724,028,800	10,029,645	9,032,996
Coin received and counted	1,687,785,000	1,434,951,000	306,071	3,023,819
Food stamps redeemed	170,343,352	189,316,312	806,378	779,028
Transfers of funds	6,129,981	5,670,374	7,537,771,275	7,704,094,000
Checks handled:				
U.S. government checks	35,746,892	36,869,773	41,499,886	41,287,843
Fine sort	173,327,631	149,977,916	61,355,995	51,663,706
All other[1]	1,064,970,786	982,228,872	597,404,421	586,137,273
ACH items handled:				
Commercial	28,860,000	20,105,000	204,543,181	49,978,833
U.S. government	21,952,000	18,271,000	12,767,997	9,908,540
Collection items handled:				
U.S. government coupons paid	59,798	85,097	36,154	41,952
All other	264,031	248,367	736,196	703,211
Issues, redemptions and exchanges of U.S. government securities:				
Definitive and book-entry	7,825,097	7,127,230	627,665,463	440,362,783
Loans: advances made	747	926	3,774,566	5,374,699

[1]Exclusive of checks drawn on the Federal Reserve Banks.

BANK HOLDING ACTIVITY

NUMBER OF BANK HOLDING COMPANIES, BANK AND NONBANK SUBSIDIARIES

	December 31, 1985	December 31, 1984
COMPANIES		
One-bank holding companies	596	559
Multibank holding companies	165	142
Total bank holding companies	761	701
SUBSIDIARY BANKS		
One-bank holding companies	549*	518
Multibank holding companies	881	750
Total subsidiary banks	1,430	1,268

*These figures are adjusted to reflect ownership of 47 subsidiary banks through intermediate shell holding companies also known as "second tier" bank holding companies.

NONBANK SUBSIDIARIES*		
One-bank holding companies	110	75
Multibank holding companies	377	350
Total nonbank subsidiaries	487	425

*Reflects only nonbank subsidiaries formed under Section 4(c)(8) of the Bank Holding Company Act.

DEPOSIT DATA FOR SUBSIDIARY BANKS OF BANK HOLDING COMPANIES

	December 31, 1985	December 31, 1984
DOMESTIC DEPOSITS IN SUBSIDIARY BANKS (millions)		
One-bank holding companies	$ 26,733	$ 26,490
Multibank holding companies	109,921	95,486
Total	$136,654	$121,976
SUBSIDIARY BANKS, PERCENT OF DISTRICT DOMESTIC DEPOSITS		
One-bank holding companies	17.0	18.52
Multibank holding companies	70.0	66.76
Total	87.0	85.28

NOTE: While there is not a significant increase in the number of bank holding companies over the past twelve months, there were 86 one bank holding company applications approved and eight multibank approvals. The approvals were offset by a number of small one bank holding company mergers, acquisitions of one bank holding companies by multibank holding companies and the dissolution of a number of small companies for tax purposes.

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January 1, 1986

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