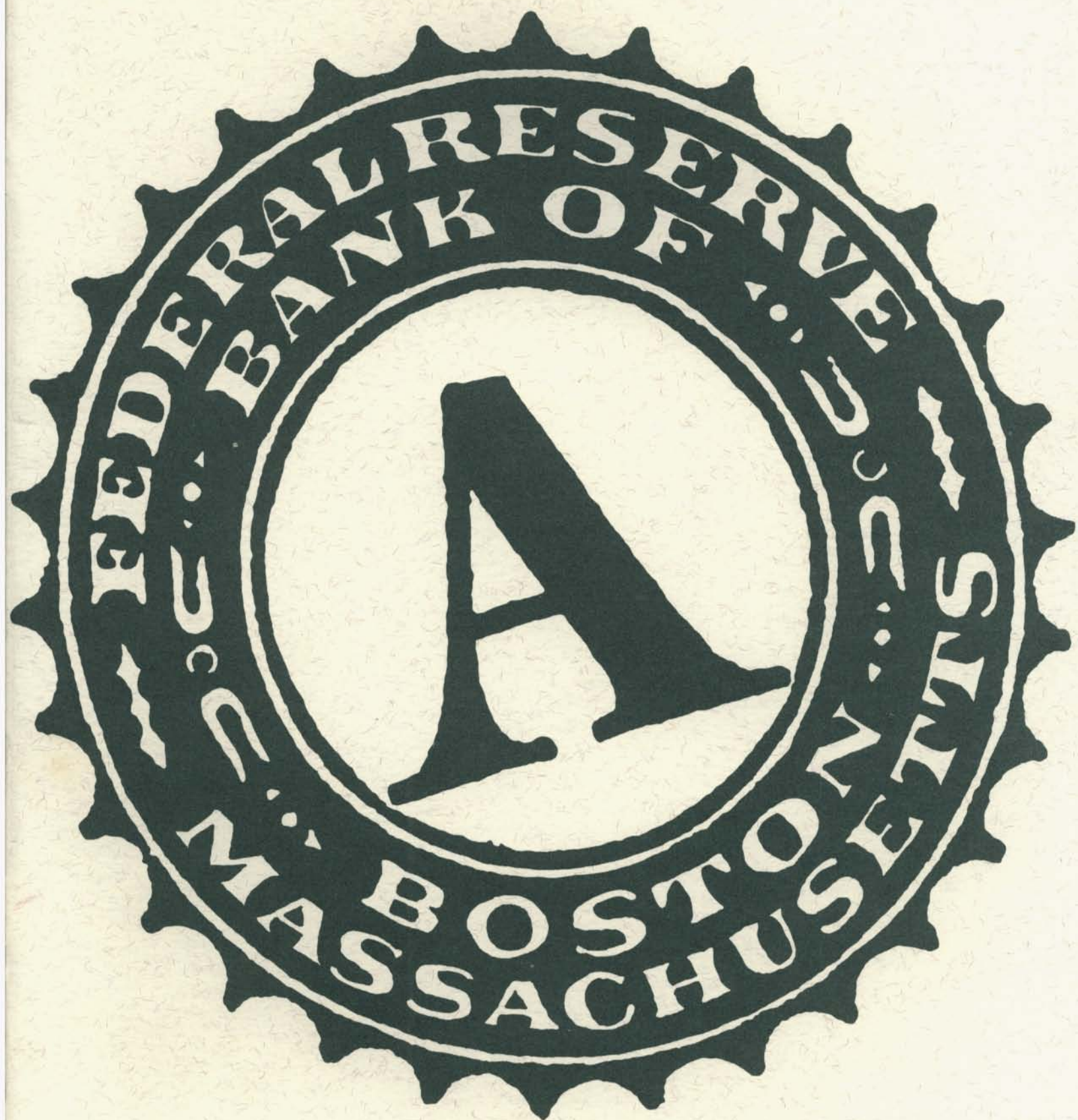


A N N U A L   R E P O R T   1 9 8 9



# ANNUAL REPORT 1989

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**Board of Directors:**

Standing left to right: Terrence Murray; Richard D. Wardell; Robert W. Eisenmenger; Richard F. Syron; Edward H. Ladd; Dr. Jerome H. Grossman. Seated: Joan T. Bok; Richard L. Taylor; Richard N. Cooper; Stephen R. Levy; William H. Chadwick

## President's Message



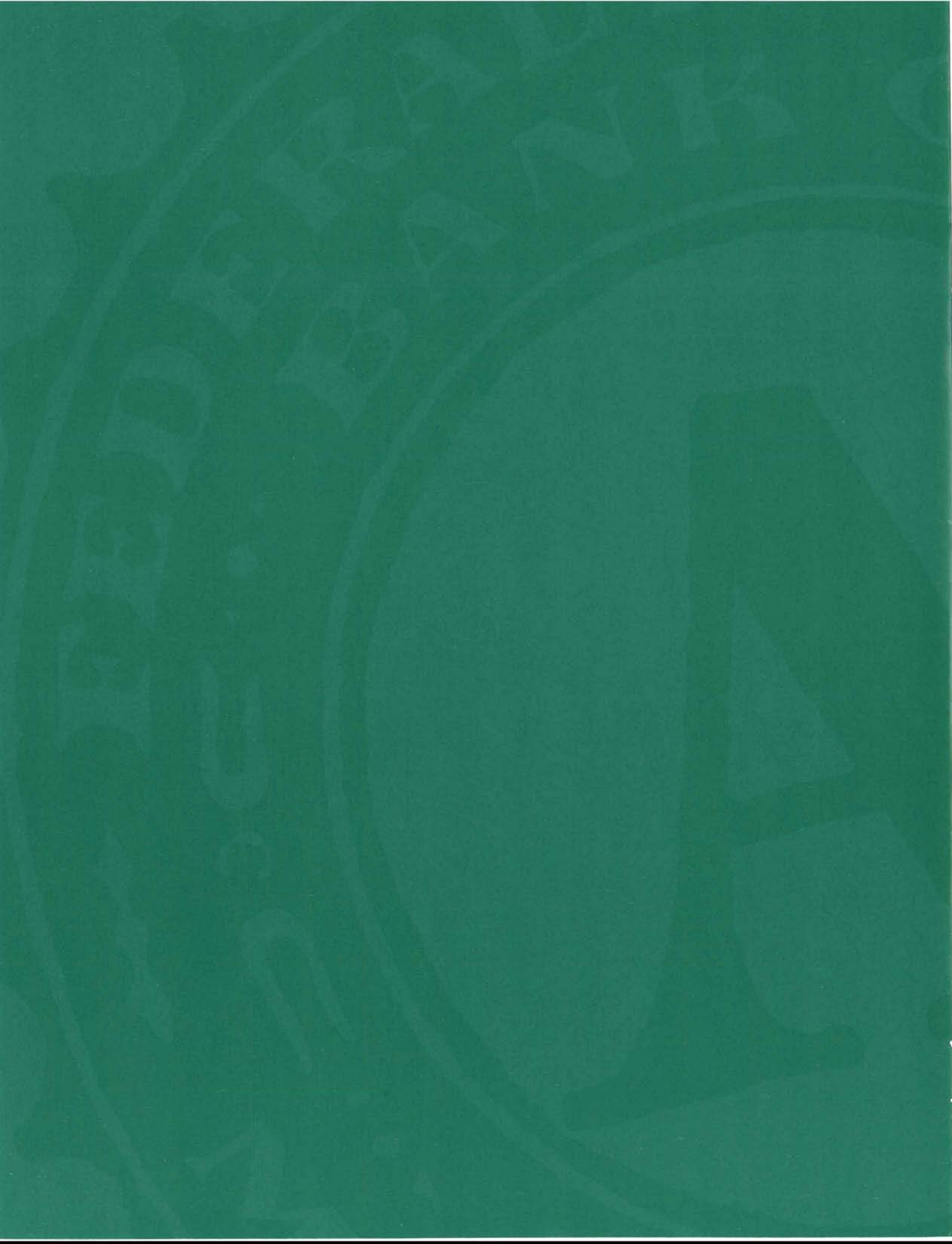
The year 1989 was a time of adjustment for New England. After nearly a decade of remarkable prosperity, the regional economy faltered, placing stress on many sectors, especially banks and thrift institutions. Just as robust growth led to over-optimistic expectations, so recent developments may breed excessive pessimism. It is timely, therefore, to examine the causes of both the acceleration and the recent deceleration of the regional economy, and to look to the future. The following comments, which make up the bulk of this Report, were prepared for delivery at a recent symposium on the New England economy. We think they provide a balanced view of the region's future.

The past year was also one in which this Federal Reserve Bank successfully confronted a series of difficult challenges. I am grateful to the Bank's dedicated directors, officers and staff, and to members of the New England Advisory Council, for their contributions and help during the past year. I would also like to extend my appreciation to New England's financial and business communities, as well as the many other groups we worked with in 1989. We look forward to continuing to work with you as the national and regional economies face the challenges of the '90s.

*Richard F. Syron*

Richard F. Syron





## One View of What the Future Holds for New England

**\*By Richard F. Syron, President and Chief Executive Officer, and Lynn E. Browne, Deputy Director of Research for Regional Affairs and Advisor to the President**

After a decade of truly remarkable growth, the New England economy has weakened. Employment fell in 1989 and the unemployment rate increased. Further weakening seems to have occurred in the early months of 1990. New England continues to compare favorably with the nation according to such common indicators as the unemployment rate and per capita income, but recent developments suggest that the region is returning to a more normal relationship with the rest of the country. This transition is proving to be quite painful for some sectors of the economy, resulting in a high degree of confusion and anxiety regarding the region's overall economic health.

This is not news, of course. And my intent in convening this forum is not to provide you with "news," in the sense that the New England economy is either weaker than previously thought or stronger than it appears to be. Nor will I play the role of seer and try to tell you precisely what will happen in New England over the next few years. I cannot reassure you that the region will quickly bounce back from its current doldrums; and I am certainly not about to tell you that an economic Armageddon is at hand.

Instead, I would like to draw upon available indicators and the experience of two decades of monitoring economic conditions in the region to place New England's current problems in perspective. Perspective, in my judgment, has too often been lacking in discussions of recent economic events. I hope that you will also share your insights, and that the ensuing exchange will both advance our understanding of current difficulties and suggest ways that we, as leaders of the business community, may help the region take advantage of opportunities for long-term growth.

### What Do Current Data Show?

The key economic indicator at the state or regional level is employment. Recent revisions to employment figures reveal the slowdown in the New England economy to be more pronounced than originally reported. Employment in the fourth quarter of 1989 was down about 1 percent from the fourth quarter of 1988. Unrevised figures had shown employment at the end of 1989 to be roughly the same as at the end of the previous year.

*\*The views expressed are those of the authors and do not necessarily reflect official positions of the Federal Reserve System. These remarks were presented by Mr. Syron at a conference on the New England economy held April 2, 1990, at the Federal Reserve Bank of Boston.*

**Chart 1**  
**Unemployment Rate**

Percent



Source: New England Economic Indicators Data Base

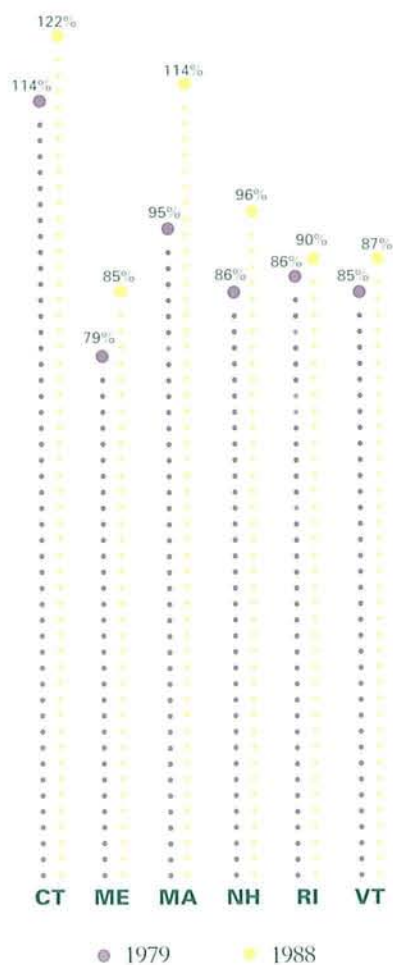
Construction employment was down sharply from the end of 1988. Manufacturing also fell over the course of the year, continuing a decline dating from the end of 1984. The largest job losses were in the major durable goods industries: fabricated metals, industrial machinery and computers, electronic and electrical equipment, and transportation equipment. Employment in transportation and public utilities was down, largely because of the NYNEX strike. Employment in trade, the government sector and the combination of finance, insurance and real estate was about the same in the fourth quarter of 1989 as in the fourth quarter of 1988. Of the major industry divisions, only services experienced significant growth.

The job losses of the past year and continued growth in the labor force have caused the unemployment rate to increase. At year end, the unemployment rate for the region as a whole was 4.4 percent. And in February, the Massachusetts rate, which is available on a more timely basis than rates for the other New England states, jumped to 5.3 percent—the same as the national average. Unemployment in Massachusetts had been below that nationally since August 1981 (Chart 1).



**Chart 2**

**Average Annual Pay in New England As a Percent of the United States**



Source: BL5 ES202 Data

### What Accounts for the Downturn in New England?

The downturn in the New England economy is not a reflection of national developments. While the U.S. rate of growth slowed in the fourth quarter, employment in the nation was up 2.4 percent over the year and the unemployment rate has been holding steady at roughly 5.3 percent.

Nor has the region suffered an economic misfortune such as the cuts in defense contracts were for New England in the early 1970s or the drop in oil prices was for Texas in the mid-1980s. Instead, forces that provided a powerful impetus to growth through much of the 1980s have weakened, and in some cases now exert a drag on the regional economy. In addition, New England is paying a price for its prosperity. When a region deviates so markedly from the rest of the country, a self-correcting process is set in motion. Sometimes there is an over-correction.

### Engines of Growth

New England benefited in the first half of the 1980s from a growing demand for computers and related products, coinciding with rising defense expenditures. New England is, of course, a center for both commercial and defense-oriented high technology industries. The region also shared in the rapid expansion of the national financial services industry in the mid-1980s. While some of the growth of financial services in New England was driven by the region's real estate boom, much was attributable to mutual funds, insurance companies and other institutions that serve national markets.

These sectors are no longer functioning as economic drivers for the region. The computer industry began to encounter difficulty towards the end of 1984, as both domestic and overseas competitors proliferated. Defense spending peaked in real terms in 1987. The boom in the national financial services industry also ended in 1987; the stock market crash in October of that year ended the era of go-go expansion.

New England is also a victim of its earlier success. The region became a costly place in which to do business. Rapid growth caused wages, rents and other costs to rise much more in New England than in the country as a whole during the 1980s. The increase in relative wages was especially dramatic. In 1979 the annual wage in the private sector was 94 percent of the national level; by 1988 the wage in New England was 108 percent of the U.S. average (Chart 2). Manufacturers are particularly sensitive to such cost pressures. When deciding where to build a new plant or where to consolidate operations in a cost-saving move, time and again, firms are choosing locations outside of New England.



New England is also confronted with the aftermath of a construction and real estate boom. The strong performance of computers, the defense industries and financial services in the early and mid-1980s required more R&D, light manufacturing and office space. The income and jobs created by these lead sectors, coupled with pent-up demand from relatively low levels of housing construction in the late 1970s and early 1980s, spurred the construction of housing and retail space.

In the mid-1980s, however, construction became an economic driver in its own right. Construction employment continued to grow rapidly despite cutbacks in high tech and the loss of other manufacturing jobs. This increase in construction played an important role in sustaining overall employment growth. With hindsight, however, this strong growth in construction without the underpinning of a strong performance by manufacturing should have been a warning sign of problems to come (see the 1984–87 time period in Chart 3).

Eventually, the expansion in the housing stock and the additions to nonresidential space outstripped the absorptive capacity of the New England economy. The impact was first felt in the housing market; sales have fallen substantially, properties move more slowly and new housing permits are close to recession levels. In the nonresidential market, effective rents have fallen sharply. In Boston, for example, effective rents fell almost 30 percent in 1989 (Chart 4). Nonresidential construction contract awards are also falling.

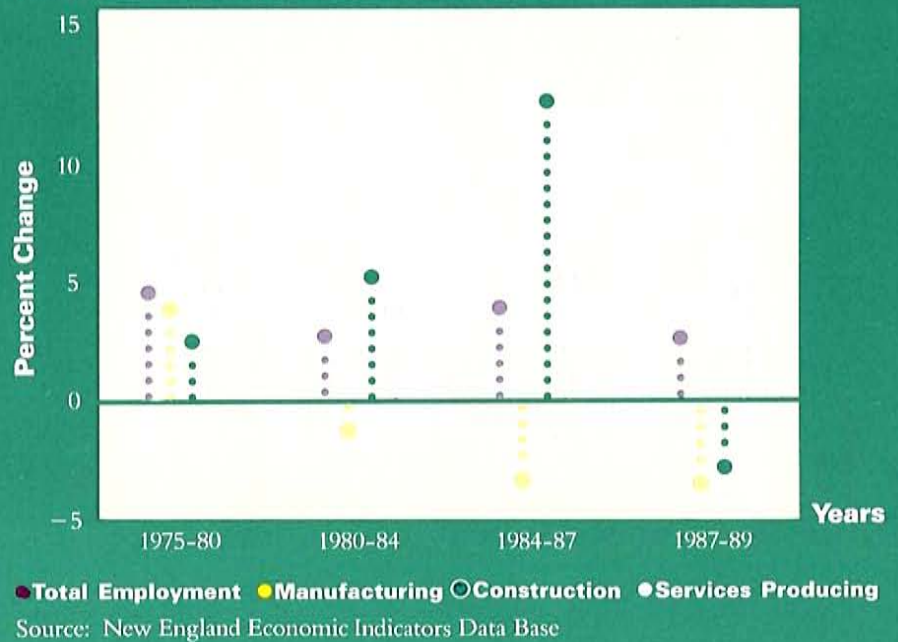
The spillovers from the difficulties in construction and real estate have been dramatic. The region's banks and thrift institutions have seen sharp increases in the number of loans for which payments of interest and principal are not current. Many in the business community, correctly or incorrectly, are concerned that credit standards have become more stringent, not only for borrowers in construction and real estate, but also for smaller and riskier businesses of all kinds.

### **An Unusual Situation**

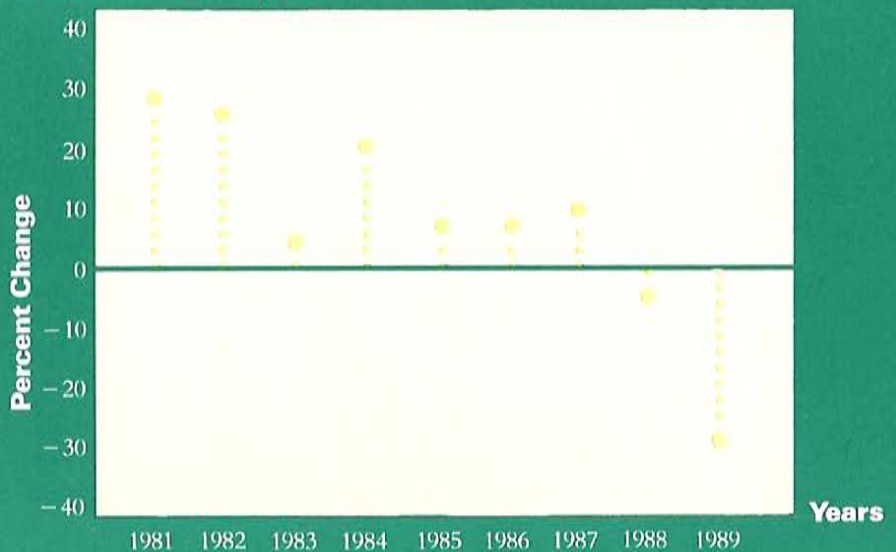
For New England to suffer an economic downturn while the nation continues to expand is unusual. In the post World War II period, the region has not suffered significant decreases in employment or increases in the unemployment rate except in national recessions. At times, most strikingly in the early 1970s, differences in industrial composition and the competitive difficulties of important regional industries resulted in a decline that was steeper and longer than that suffered by the nation. However, the regional downturn always occurred in the context of a national recession.

*“... construction  
became an economic  
driver in its own  
right.”*

**Chart 3**  
**Employment in New England**  
**Percentage Changes at an Annual Rate**



**Chart 4**  
**Percentage Change in Effective Rents in Boston**  
**in Midrise Tower Space**





One implication of this divergence between the region's economic performance and that of the nation is that one cannot simply look to the national outlook to project what will happen to the region. National factors are very important, but something else is at work as well. As a result, forecasts of such variables as interest rates, the value of the dollar or consumer confidence provide—at best—an incomplete guide to the region's future performance.

Given the unusual character of the current downturn, it is tempting to look for analogies in the experiences of other parts of the country. Texas and other southwestern states leap immediately to mind. The difficulties of the oil producing states are still fresh in memory and the fact that financial institutions in both the Southwest and New England came under stress in the wake of regional economic downturns is an obvious point of similarity. However, to conclude that Texas is a model for New England is misleading. It is also misleading to deny the existence of any similarities.

Both Texas and New England experienced substantial and prolonged employment declines in industries that are commonly seen as economic drivers, oil and gas exploration and related manufacturing industries in Texas and manufacturing generally in New England. This weakness was offset for several years by the momentum of the nonmanufacturing sector and by the strength of the construction, real estate and financial services industries in particular. Moreover, because construction, real estate and financial services were so very strong, their subsequent difficulties were all the more severe. The parallels stop there, however.

While the decline in manufacturing in New England has been substantial, it is unlikely to match the severity of the falloff in oil and gas exploration and related manufacturing in Texas. Another important difference between the two areas is population growth. The downturn in construction in Texas and the fall in real estate values were exacerbated by a dramatic shift in migration patterns. Texas had experienced a very substantial inflow of population in the early 1980s; this dried up when the state ran into economic difficulty. In New England, population growth did not pick up much in response to the region's remarkable prosperity; presumably, therefore, it will not slow much in response to the current downturn. Undoubtedly there are lessons to be learned from those similarities that do exist between New England and Texas, but the lesson is not that New England is another Texas.

*“... it is tempting to look for analogies in the experiences of other parts of the country.”*

*“The volume of construction activity in New England during the mid-1980s was very high...”*

If the national experience provides an incomplete guide to New England’s future and comparisons with other regions are likely to be misleading, how should one approach the task of forecasting the region’s economic performance?

### **What Shapes the Regional Outlook in the Short Term?**

The short-term outlook will be dominated by developments in construction and manufacturing. These are the industries that suffered the greatest job losses in 1989 and they are inherently more volatile and, in current circumstances, more prone to employment cutbacks than most other industries. A key reason for their greater volatility is the fundamental distinction between industries that produce goods and industries that produce services. Construction and manufacturing are goods-producing industries. Trade; finance, insurance and real estate; transportation and public utilities; government and, of course, “services” are service-producing industries.

A service is not lasting; it cannot be stored. Since purchases of services cannot readily be stockpiled or postponed, consumption of services and the activity levels of the service-producing industries tend to be more stable than activity in goods-producing industries. The contrast between the service-producing industries and construction is particularly sharp.

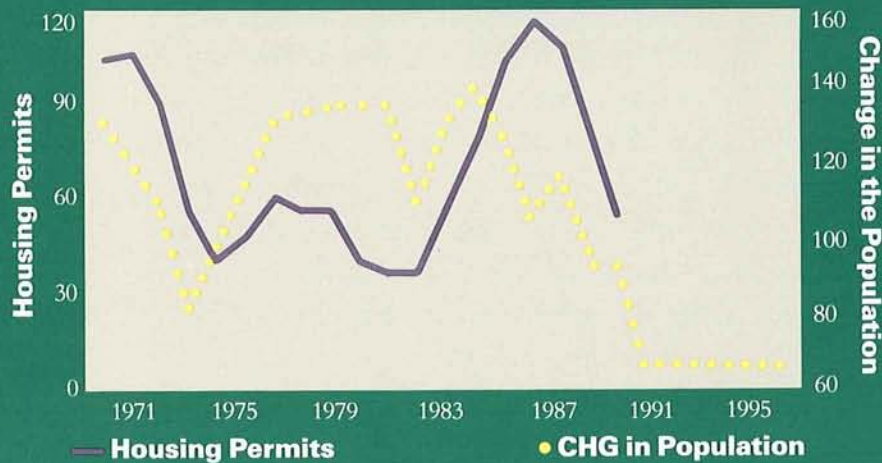
The volume of construction activity in New England during the mid-1980s was very high—both by historical standards and in relation to population and household growth. Such high levels of activity were not sustainable. The industry is not in a temporary slump; rather, it is shifting to a level of activity more consistent with the long-term economic and demographic characteristics of the region.

It has become commonplace to attribute the industry’s problems to speculation and overbuilding. One should recognize, however, that housing construction in New England was depressed during the late 1970s and early 1980s, while the growth of the adult population was quite high. This created a pent-up demand for housing. When the industry finally responded to this pent-up demand, the response was extraordinarily rapid. The very high levels of housing construction in the mid-1980s meant the housing deficit was filled in a very short period. Such high rates of activity are no longer justified. The appropriate rate of construction is one consistent with the growth in the number of households. And here is an additional consideration: Not only must the industry shrink because the capacity created in response to pent-up demand is no longer needed, but a slowing in the growth of the adult population means that the on-going need for new housing construction has decreased (Chart 5).



**Chart 5**

**Annual Housing Permits and Change in the Adult Population in New England**



Source: Population—Census, Various publications, and BEA. Housing permits—New England Economic Indicators Data Base

New England is not alone in facing slower growth in the adult population. Nationally, the growth in the adult population is also slowing. This implies slower growth in the number of households and fewer additions to the housing stock. The adjustment for the nation will not be as severe as that in New England, however, because the nation did not experience such high levels of housing construction in the mid-1980s.

This reasoning carries over, with some qualifications, to nonresidential construction. A substantial portion of the nonresidential construction activity in New England in the 1980s can be seen as catch-up, compensating for too little construction in prior decades. One has only to look around to see that this catch-up is largely complete. In addition, slower growth of the adult population will mean slower growth of the labor force. Slower growth of the labor force may, in turn, cause the underlying demand for office and industrial space to grow more slowly.

The outlook is considerably brighter for public construction. In Massachusetts, in particular, there is broad agreement that we have invested too little in public infrastructure and that the time is right to rectify this situation. Increased public works construction will not offset the decline in private construction, however.

Nonbuilding construction, which consists largely of public works projects, accounts for only 20 percent of the total value of construction contracts.

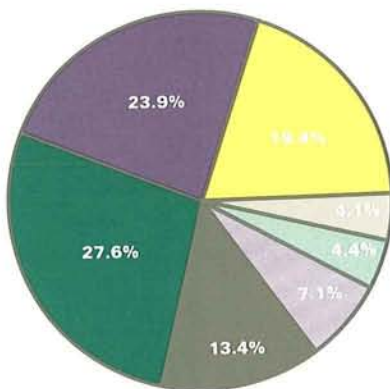
The prospects for manufacturing are more encouraging. And because manufacturing is much larger than construction, accounting for about 20 percent of employment compared to construction's 5 percent, developments in the manufacturing sector are even more critical to the regional outlook.

Manufacturing is one sector for which the downturn in the New England economy represents, on balance, good news. Most manufacturers in New England sell in national and international markets. The downturn in the region does not affect their sales prospects to any appreciable degree. Printing and publishing is an important exception. But for most manufacturers, it is the national economy that matters. And since the national expansion is expected to continue, albeit at a modest pace, a pronounced weakening of the manufacturing sector's performance seems unlikely.

Moreover, while the downturn in the region does not hurt the revenues of New England manufacturers, it should help their costs. Labor availability is no longer a widespread problem. Space costs are down. Indeed, the silver lining to the downturn in New England is that cost pressures will ease. And just as manufacturing profits were squeezed when costs went up, manufacturing will benefit more than other industries when these cost pressures abate. However, these positive effects will probably not be felt for a year or two. So just as one should not expect a marked deterioration in the manufacturing sector's performance, one should not look for a marked improvement—at least not in 1990.

While portions of the service-producing industries also serve national markets, much of the service-producing sector is locally or regionally oriented and is adversely affected by a regional downturn. Sales and earnings growth slows in the trade and services industries. Weak tax collections create pressure to curtail state and local government activities. The finance, insurance and real estate industry certainly suffers, although the impact varies greatly from one segment of the industry to another. However, while the service-producing industries are affected by the job and income losses in manufacturing and construction, they are inherently stable. This stability is an important virtue in current circumstances, since it means that employment generally holds up in economic downturns. About three-fourths of the jobs are in the service-producing industries (Chart 6).

**Chart 6**  
**Industry Mix in New England**  
**December 1989**



1989	%
Manufacturing	19.4%
Fin., Insur., & RE	7.1%
Trade	23.9%
Construction	4.4%
Services	27.6%
Trans., Pub. Util.	4.1%
Government	13.4%

Source: New England Economic Indicators Data Base



In short, these three factors—the small size of the construction industry; the support that a continuing national expansion will provide the manufacturing sector; and the inherent stability of much of the regional economy—argue that the downturn in New England in 1990 will be moderate.

### **Outlook for 1990**

A distinct possibility is that 1990 will be a repeat of 1989, with total non-agricultural employment falling about 1 percent from fourth quarter to fourth quarter. The unemployment rate would rise up to and probably exceed a national average of roughly 5.5 percent. Underlying the overall decline in employment of 1 percent would be a sharp decline in construction employment (about 10 percent) and a more moderate (about 5 percent) decline in manufacturing. Services would grow modestly, less than 2 percent, under this scenario; employment in the remaining industries would be flat to down slightly.

Although the 10 percent drop in construction employment, following upon a similar decrease in 1989, is substantial, it would still leave construction employment about where it was in 1985. Housing permits are below what they were in 1985. Residential and nonresidential construction contracts, measured in square feet, are also below their 1985 levels. Nonbuilding construction is picking up, but nonbuilding construction is not large enough to offset the decline in other components, at least not in 1990.

One can be somewhat more positive about the manufacturing sector. A decline of 5 percent in New England manufacturing employment would continue the relationship between regional and national manufacturing that has existed for the past several years, with the performance of regional manufacturing employment about 4 percentage points weaker than manufacturing employment nationwide. However, one can envision circumstances under which the region might improve upon this record; it would require that the easing in cost pressures have an immediate positive effect, that new products being introduced by the computer and other high tech industries be received favorably, and that new management strategies being adopted by some of these same companies prove effective. The most obvious threat to the region's manufacturing sector, the prospect of significant cuts in defense procurement and research, still seems a few years away.

The region's services, trade, and finance, insurance and real estate industries exhibited considerable vitality until recently. However, even apart from the spillovers from the job losses in construction and manufacturing and the nation-

*“One can be somewhat more positive about the manufacturing sector.”*

wide slowdown in financial services, such vigorous growth rates were not sustainable given New England's slow population growth. Moreover, much of the recent growth in services was attributable to temporary help, business services, and accounting, legal and other professional services that will be affected by the regional downturn. Accordingly, services growth will slow in 1990 and employment in trade and finance, insurance and real estate will probably be flat to down slightly.

In summary, it seems realistic to expect that total nonagricultural employment in New England will fall another 1 percent over the course of 1990, with the industry pattern resembling that in 1989. The greatest risk to the regional economy, apart from a national downturn, is the possibility that the decline in construction will be even more severe than in 1989. The difficulties of the region's depository institutions also represent a wild card in any forecast. The economics profession is divided on the question of the extent to which such problems affect activity in other sectors.

A decline in employment of 1 percent, following the decrease experienced over the course of 1989, would be about the same as the decrease in employment the region experienced in the 1981-82 recession. That was a relatively mild recession for New England, but a recession nonetheless. Fortunately, the region entered the present downturn with such a tight labor market that even with the projected drop in employment, the unemployment rate should remain close to the national average. Per capita income in the region will remain well above the national average.

Forecasting more than one year forward is always problematic, and New England's current circumstances make such an exercise especially difficult. In the past, regional downturns have occurred in the context of a national recession and forecasts of a turnaround could be based on changes in interest rates or exchange rates. The duration of the present downturn and the vigor of the subsequent recovery depend upon how rapidly the region can grow into its expanded stock of housing and nonresidential property, and upon how quickly some industry or group of industries emerges to serve as an engine of growth for the region.

*“Per capita income in the region will remain well above the national average.”*

### **The Longer Term**

For New England to preserve the economic gains made in the 1980s requires that some industry or group of industries function as an engine of growth for the region as computers, the defense industries and nationally oriented financial



services did, in spectacular fashion, not so long ago. Simply sharing in national trends is not sufficient for New England to retain its position. Historically, the region has grown by fits and starts, advancing rapidly and achieving high levels of prosperity when key industries were in an expansive phase and losing ground as growth in these lead sectors subsided. In each lull, the question has arisen: what sector will provide the next impetus to growth and when?

To some extent, believing that a new engine of growth will emerge represents an act of faith. Faith in history: new engines of growth have appeared in the past, they will do so again. Before computers in the late 1970s and early 1980s, aerospace and instruments propelled growth in the 1960s. In the 1950s a variety of durable goods manufacturing industries helped offset huge losses in textiles.

No industry is currently an obvious candidate to succeed computers and serve as the engine of growth of the 1990s, but the following examples illustrate that the potential exists for such a lead industry to emerge and to have a significant impact within a relatively short time.

In the services sector, the computer software and data processing industry now employs roughly the same number of people in New England as the manufacture of computers. While the performance of some of the larger firms in the region has been mixed recently, the consensus is that the industry will grow at a healthy rate in the 1990s. Engineering services is also a relatively large industry in New England. Infrastructure requirements, energy needs and global environmental concerns would seem to favor growth in this industry over the long term.

In manufacturing, the instruments industry may offer promise. New England is very prominent in the manufacture of medical instruments, measuring and controlling instruments, and search, navigation, guidance and aeronautical instruments. Advances in medical care should foster the growth of medical instruments, while concerns with the environment could bolster the demand for instruments that measure air and water quality and monitor the weather. The demand for search, navigation and aeronautical instruments is vulnerable to cutbacks in defense spending; but one can also imagine a flowering of commercial opportunities—for example, collision avoidance systems for commercial aircraft and improvements to instrument landing systems.

Believing in a new engine of growth also means having faith in New England's strengths as a center for innovative, knowledge-intensive industries. Historically, one of New England's great advantages has been a diverse, highly skilled

***"In manufacturing, the instruments industry may offer promise."***

*“The research conducted at New England’s universities has also been a source of new technologies...”*

labor pool and industrial base. The advantage lies not so much in diversity per se, but rather in an unusual clustering of diverse, but related, skills and technologies. In combination with an entrepreneurial culture, this has created an environment favorable to innovation and the development of new products, firms and industries. For example, the region’s medical instruments industry has roots in the area’s early prominence as both a medical center and a center for metal-working. Today, strengths in the computer and software industries are also seen as assets in the development of medically related products and firms. The opportunities for cross-fertilization that proved so productive in the past still exist.

New England’s institutions of higher education continue to be sources of highly educated manpower and new technologies. Students come from all over the country and increasingly all over the world to attend the region’s prestigious universities. Many stay, representing a “brain gain” for the region.

The research conducted at New England’s universities has also been a source of new technologies and new ventures. Massachusetts’ leadership in both the computer hardware and the software industries arises directly from research at M.I.T., Harvard and other local universities. The recent defense buildup brought hundreds of millions of dollars in research monies into the state; if the past is any guide, this research will have spinoffs in the form of new commercial products and new companies. The region’s medical institutions also show promise of playing more of a role as generators of new business opportunities. Some have been very successful in recent years in attracting funds for research in the health sciences. Scientists from around the world are coming to study in New England labs.

In the past, the development of innovative firms and industries was aided by a diverse and highly sophisticated financial services industry. Particularly important advantages for the region were its concentration of venture capital firms and the expertise of New England’s banks in lending to high technology companies. At the moment, the difficulties of the region’s banks have forced them to become more conservative. (A nationwide increase in risk premia may be reinforcing such tendencies.) The region’s venture capital firms have been accused by some observers of abandoning start-ups and early-stage companies in favor of leveraged buy-outs. However, the expertise is there. The difficulties of New England’s banks will be resolved. And perhaps without the lure of seemingly easy money in real estate, New England’s banks will focus their energies on their traditional strengths, including experience in lending to high-growth,



knowledge-intensive firms and industries. Similarly, the problems in the junk bond market may steer venture capital firms away from the world of LBOs and back to financing new ventures.

More generally, it can be argued that current problems are creating a climate conducive to innovation and the development of the next round of new or invigorated companies and industries. When all is going well, the tendency is to continue along the established path. The best minds are attracted to established companies, which tend to stick to established ways of doing business. But the world changes and what was successful in the past may not be successful tomorrow. A region such as New England that lacks natural resources or a central location or low-cost labor can only thrive by doing things better than other places. Hard times tend to renew the creative juices.

***“Hard times tend to renew the creative juices.”***

While this may sound like a Pollyanna's wishful thinking, consider New England's experience in the early 1970s. Because of the difficulties of the region's defense contractors and traditional import-vulnerable industries, the early 1970s was the economic low point of the post World War II era. However, the availability of professional and technical manpower from the shrinking defense industry spurred the growth of the fledgling computer firms. The public sector became much more sensitive to the importance of a favorable business climate, much more energetic in pursuit of economic and community development. The stage was set for the region's economic revival in the late 1970s and the truly remarkable performance of the 1980s.

What can be done to make sure the process of creative destruction in New England is more creative than destructive? Not only will productive action directly speed the transition to a new growth environment, but evidence of useful action will also allay the anxiety and pessimism that seem to be engulfing the region and that threaten to inhibit the emergence of new engines of growth. It is all very well to talk about creative destruction, but creation in the business world requires investment and investment occurs where there is confidence in the future.

### **Prescriptions**

While the 1980s was a remarkable, but unfortunately unsustainable, period, the question now facing all of us is: How can we make the most out of the nineties and set the stage for New England in the 21st century? What can each of us do to influence events?

### **First, Federal Reserve**

We have responsibility for closely monitoring the region's economic health and for being an impartial and reliable source of information. We intend to fulfill that responsibility. This symposium is just one of our ongoing efforts to reach out into the region, and we will continue to do more in the region. We have a new publication about the New England economy scheduled to debut later this year, for example.

### **Second, State and Local Governments**

Economic decision-makers are repelled by fiscal instability. It is imperative, therefore, that state and local governments in Massachusetts and the other New England states come to grips with their current fiscal difficulties in such a way as to provide some assurance about future tax and service levels. These difficulties are casting a pall over the economy not just of Massachusetts but of the entire region. On the other hand, the debate taking place in Massachusetts is focusing attention on structural problems in the government sector that have vast implications. Particularly in the area of health care, fundamental changes are needed.

### **Third, Business**

However current fiscal difficulties in the region are addressed, slower economic growth will restrain expenditure growth for some time to come and will force state and local governments to establish spending priorities. Businesses must make their voices heard in this process. Education is one area where there appears to be considerable commonality of interest. Judicious spending on public infrastructure may also help lay the foundation for future growth. Recent studies of public expenditures on infrastructure nationally suggest that a lack of public investment is one cause of the productivity slowdown. However, priorities must be established. Not all public works projects will yield economic benefits commensurate with their costs.

*“Judicious spending on public infrastructure may also help lay the foundation for future growth.”*

Business should also press governments in the region to review their regulatory systems to ensure that the benefits of various regulations exceed the costs. It is entirely appropriate for the government to determine that, under some circumstances, economic development should be sacrificed in favor of environmental or safety concerns. However, inadvertently thwarting economic development through a failure to consider the implications of the regulatory process amounts to a carelessness that the region cannot afford.

Business cannot expect government to do it all. Business must renew its own commitment to the region. Utilities, banks and retailers have an obvious inter-



est in the prosperity of New England. But manufacturers and other organizations serving national markets also benefit from the region enjoying a high degree of economic vitality. Fears that New England is entering an extended period of economic difficulty can pose a serious disadvantage. It will become harder to recruit the professionals and other high-level workers who are so important to New England industry.

Business leaders should consider how they can help revitalize the region. This may mean working with state, local and federal officials to promote New England. As members of trade associations and other organizations, business leaders can encourage the gathering and dissemination of information on new opportunities and challenges facing New England. For example, the experiences of those companies that have pioneered in investing in Eastern Europe may be instructive to others contemplating such activity.

### **Next, Academic Institutions**

The region's universities and colleges have always been one of our greatest natural assets. In fact, they are one of our leading export industries. However, we need their help to an even greater degree today. Just like the rest of us, they are citizens of our region. Their unparalleled reservoir of intellectual power and research skills has in the past helped revitalize the region. It is essential that they strengthen their efforts in addressing regional concerns.

### **Finally, the Media**

The media, both print and electronic, have one of the most important roles of all. They are the mechanism through which public opinion is formed. It is on the basis of the news they report and how they report it that people develop their sense of the health of the economy. The media cannot be and must not be cheerleaders, for that would rob society of that most important role they play: the objective observer.

However, along with this responsibility and privilege goes the obligation to ensure that what is being reported is accurate and objective. The need to avoid, in a competitive climate, the quick splash in favor of a more careful analytical perspective, is of utmost importance.

All in all, if we can work together in a spirit of harmony and goodwill, I am confident that the outlook for New England is indeed promising. While we may not be able to live forever in the glory days of leading the pack, neither do we need to fall to the rear as happened to us in earlier periods.

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## Statement of Condition

<b>Assets</b>	<b>December 31, 1989</b>	<b>December 31, 1988</b>
Gold Certificate Account	\$ 699,000,000	\$ 680,000,000
Special Drawing Rights Certificate Account	531,000,000	314,000,000
Coin	26,281,429	20,279,657
Loans and Securities:		
Loans to Depository Institutions	5,300,000	42,200,000
Fed. Agency Obligations Bought Outright	406,004,603	422,799,696
U.S. Gov't Securities-System Account	<u>14,111,463,318</u>	<u>14,181,077,676</u>
Total Loans and Securities	14,522,767,921	14,646,077,372
Cash Items in Process of Collection	469,884,141	480,156,215
Bank Premises (net)	90,940,632	91,522,662
Other Assets	1,407,849,339	613,128,666
Interdistrict Settlement Account	<u>2,705,027,286</u>	<u>605,008,684</u>
Total Assets	<u>\$20,452,750,748</u>	<u>\$17,450,173,256</u>
<b>Liabilities</b>		
Federal Reserve Notes (net)	\$17,165,574,526	\$14,322,030,778
Deposits:		
Depository Institutions	2,509,661,255	2,386,164,589
Foreign	5,250,000	4,950,000
Other	<u>52,047,084</u>	<u>20,552,271</u>
Total Deposits	2,566,958,339	2,411,666,860
Deferred Credit Items	375,466,120	372,897,267
Other Liabilities	<u>178,217,563</u>	<u>193,668,151</u>
Total Liabilities	<u>\$20,286,216,548</u>	<u>\$17,300,263,056</u>
<b>Capital Accounts</b>		
Capital Paid-In	\$ 83,267,100	\$ 74,955,100
Surplus	<u>83,267,100</u>	<u>74,955,100</u>
Total Capital Accounts	<u>166,534,200</u>	<u>149,910,200</u>
Total Liabilities & Capital Accounts	<u>\$20,452,750,748</u>	<u>\$17,450,173,256</u>

## Statement Of Earnings and Expenses

	<b>December 31, 1989</b>	<b>December 31, 1988</b>
Current Earnings:		
Advances to Depository Institutions	\$ 2,569,813	\$ 1,537,138
Invested Foreign Currency	36,218,306	9,892,553
U.S. Gov't Securities & Agency Obligations-System Account	1,236,135,580	1,099,303,526
Income from Services	48,019,383	44,833,234
Penalties on Deficiencies in Required Balances	160,787	250,956
Penalties on Overdrafts	112,511	137,429
Treasury Securities Transfer Fees	271,745	262,703
Total Current Earnings	1,323,488,125	1,156,217,539
Less: Current Expenses	76,844,990	75,732,969
Cost of Earnings Credits	9,605,023	7,837,385
Current Net Earnings	1,237,038,112	1,072,647,185
Additions to Current Net Earnings:		
Net Profit on Sale of U.S. Gov't Securities	823,379	1,405,315
Net Profit on Foreign Exchange Transactions	45,075,533	-0-
All Other	4,230	20,824
Total Additions	45,903,142	1,426,139
Deductions from Current Net Earnings:		
Net Loss on Foreign Exchange Transactions	-0-	16,858,888
Cost of Unreimbursed Treasury Services	1,776,930	1,499,201
All Other	1,241	9,431
Total Deductions	1,778,171	18,367,520
Net Addition (Deduction) to Net Earnings	44,124,971	(16,941,381)
Assessments by the Board:		
Board Expenditures	3,207,100	2,848,500
Federal Reserve Currency Costs	10,871,391	9,713,790
Net Earnings before Payments to U.S. Treasury	<u>\$1,267,084,592</u>	<u>\$1,043,143,514</u>
<b>Distribution of Net Earnings</b>		
Dividends Paid	\$ 4,737,306	\$ 4,385,524
Payments to U.S. Treasury (Interest on Federal Reserve Notes)	1,254,035,286	1,032,070,290
Transferred to Surplus	8,312,000	6,687,700
	<u>\$1,267,084,592</u>	<u>\$1,043,143,514</u>



## Summary of Operations

	Calendar Year, 1989		Calendar Year, 1988	
	Daily Average Volume	Daily Dollar Value of Transactions	Daily Average Volume	Daily Dollar Value of Transactions
<b>Services to Depository Institutions</b>				
<b>Wire Transfer of Funds</b>	27,400 transfers	\$65.0 billion	25,600 transfers	\$57.9 billion
<b>Automated Clearing House</b>	386,000 items	\$1,309 million	331,000 items	\$1,155 million
Commercial ACH Items	295,000 items	\$1,235 million	246,000 items	\$1,096 million
Government ACH Items (Direct Deposit)	91,000 items	\$74 million	85,000 items	\$59 million
<b>Check Processing</b>				
Total Volume	5.3 million checks	\$3.5 billion	5.2 million checks	\$3.6 billion
Processed Volume	3.8 million checks	\$2.9 billion	3.9 million checks	\$3.0 billion
Fine Sort Volume	1.5 million checks	\$ .7 billion	1.4 million checks	\$ .6 billion
<b>Cash Operations</b>				
Cash Shipped	5.6 million notes	\$70 million	5.5 million notes	\$71 million
Cash Received	5.1 million notes	\$61 million	4.9 million notes	\$59 million
<b>Services to U.S. Treasury</b>				
Electronic Book Entry Transfers	4,247 transfers	\$68.7 billion	3,500 transfers	\$54.0 billion
Savings Bonds Issued	4,757 bonds	\$ 1.2 million	4,700 bonds	\$ 1.1 million

## Board of Directors

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## New England Advisory Council



Standing left to right: John E. Flynn; Howell Hughes; Richard L. Taylor; Roger D. Hewson; Paul H. Johnson; Joseph R. Alosa, Sr.; Seated: Richard F. Syron; Harry W. Blunt, Jr. Not pictured: Charles Grigsby; Richard A. Kaplan; Douglas Nelson; Arthur J. Pappathanasi; Frank C. Romano, Jr.

### **Harry W. Blunt, Jr. (Chairman)**

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Concord, New Hampshire

### **Joseph R. Alosa, Sr.**

President  
Patsy's Inc.  
Concord, New Hampshire

### **John E. Flynn**

International Vice President  
IBEW-2nd District  
Quincy, Massachusetts

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Scott and Duncan Co., Inc.  
Boston, Massachusetts

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President  
Sabre Yachts  
South Casco, Maine

### **Howell Hughes**

Wilbraham, Massachusetts

### **Paul H. Johnson**

President  
Connecticut Savings Bank  
New Haven, Connecticut

### **Richard A. Kaplan**

Kaplan, Moran & Associates, Ltd.  
Providence, Rhode Island

### **Douglas Nelson**

Derby Line, Vermont

### **Arthur J. Pappathanasi**

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West Lynn Creamery, Inc.  
Lynn, Massachusetts

### **Frank C. Romano, Jr.**

President  
Elder Care Services  
Rowley, Massachusetts

### **Richard L. Taylor**

President  
Taylor Properties, Inc.  
Boston, Massachusetts



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