# *Chartering, Branching, and the Concentration Problem*

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Nobody who has worked on and witnessed multi-member task forces in operation can be too optimistic about their results.[1] Yet, having started with such a gloomy premise, I was pleased by what the Hunt Commission turned out on competitive policy. From the outset, the Commission's report stresses competition as a major, affirmative policy:

> The American financial system is unique in the modern world. Made up of tens of thousands of highly diversified individual units, ranging from general purpose to specialized institutions, its structure mirrors the decentralized free enterprise economy which it serves.
>
> The system did not evolve through happenstance. For well over a century the American public has insisted that its financial institutions be both competitive and sound. The two objectives are not easily reconciled, and yet both must be achieved if we are to avoid, on the one hand, a highly concentrated financial structure and, on the other, a system unable to withstand the vicissitudes of economic change. The public is entitled to the benefits of a dynamic and innovative system responsive to shifting needs. Yet the public also should be able to rely on the strength and soundness of the system.[2]

This clear and affirmative theme – the need to assure both efficiency and safety – recurs throughout the report.

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The views expressed are those of the author and do not necessarily represent the Department of Justice. The Department normally would not have any occasion to take a position as such on the Hunt Commission Report. It will of course have to consider any legislative proposals, affecting competitive policy, in the future when these are formulated.

[1]See, e.g., the Antitrust Division's comments on the Ash Council Report on administrative agencies. 57 VA.L.REV. 925 (1971).

[2]*The Report of the President's Commission on Financial Structure and Regulation,* 1971, p. 1.

At the same time, the Hunt Commission is fairly conservative – or should one say "realistic" – in facing the broad issues of the day. It offers us an improved model of the status quo, rather than a grand plan for the next generation. Its "bottom line" judgments on competitive questions are generally sound, even though it fails to spell out its detailed underlying rationale in many cases. This conservatism can be illustrated by looking at the Commission's discussion of payment of interest on demand deposits (see pp. 27-29): it articulates most of the reasons why interest should be permitted on such deposits, and then comes out the other way in a rather delphic four-line paragraph beginning "Even so. . . ." This decision seems to rest on the concern that "immediate abolition" would adversely affect thrift institutions, and have other "potential deleterious effects."[3]

In approaching the broad issue of market structure, the Commission does not seem to come to grips openly with the underlying questions in any detail. I believe that these questions are at least two in number: first, *why* do we directly regulate market structure in banking? And, secondly, *how* should we regulate bank structure – which is a matter of both agency structure and substantive legal standards?

There seems to me to be a great tendency, not only in banking but in other regulated industries, to muddle through on fundamental questions like these. To do so is to make regulation seem obscure and highly technical – much loved by the inside experts, but rather poorly understood by the public at large. So, therefore, let's ask the questions.

*Why do we regulate bank structure*? One can imagine a variety of arguments, of varying degrees of persuasiveness and plausibility, as to why bank structure is regulated. These include the following:

(1) To protect banks, depositors, and communities from bank failures;

(2) To protect banks from possible "destructive competition;"

[3]Of course, there would be transitional difficulties of elimination of this prohibition of payment of interest against demand deposits. There are similar interim problems in elimination of rate ceilings against time deposits, which the Hunt Commission endorses, on a gradual basis. (see pages 23-26). Yet Professor Samuelson has stressed, ". . .The main thrust of economic analysis [is] that we *evolve* away from dependence upon these inefficient and inequitable devices." See Samuelson, "An Analytic Evaluation of Interest Rate Ceilings For Savings and Loan Associations and Competitive Institutions," *Study of the Savings and Loan Industry*, Part IV (Washington, D.C., July 1969), 1563, at 1589.

(3) To protect small banks from the competition of large banks;
(4) To assure bank shareholders of an adequate rate of return on their capital;
(5) To protect bank managements from their own follies; and
(6) To deal with the actual or imagined evils of "concentration."

To state goals in this way makes the whole process sound a little silly. We know that regulation of bank structure "just growed" – and it did so in response to economic conditions that are entirely different from those we face today. It began before the Civil War. Later, amid the gloomy shadows of the Great Depression, banking regulation, especially on new entry, burst forth as a means of saving the country from even more bank failures. It was designed to both curb the expansive bank and protect the weaker one. Today, conditions are entirely different, and these factual premises need to be reexamined in the light of today's needs. For example, assuming bank failure is the risk which we seek to avoid, can we find anything in the experience of the last decade or so which shows a close relationship between bank structure regulation and bank failure? I think not – as most recent bank failures and near failures have been brought on by the doubtful activities of various entrepreneurs running banks, by a mixture of gross incompetence and/or outright fraud.

On the other hand, if the purpose of bank structure regulation is to protect the weaker competitor, then really should such protection go on forever? In the 1970s such a solution might be regarded the way we do a fuse box – as a temporary protection for an existing wiring system, but not as a permanent excuse for failure to rewire the house to meet current needs.

*How should we regulate structure*? At issue here is the broad question – addressed at least in part by the Commission – of dual regulation as between state and federal agencies and the question of the legal standards to govern the regulator's conduct.

Competitive regulation – and that's what it is – is a phenomenon largely unique to banking. It is a useful tool (although some would say a cosmetic) if our overriding goal is to keep down the level of effective public regulation. This is important because there is a natural tendency for regulators to favor enterprises subject to their

regulation, over the needs of third parties or the public generally.[4] Dual regulation of bank entry works against this protectionist tendency since one or the other chartering authority may let a new entrant in.[5] The Hunt Commission recognizes this practical truth in supporting dual regulation. A single agency, it says, "may become over-zealous in protecting existing firms, with the result that entry by new firms is effectively foreclosed" (p. 60).

On the other hand, in the bank merger area, competitive regulation has often served us poorly. Chairman Frank Wille at the F.D.I.C. made this point clearly in an excellent speech in early 1971.[6] There is a continuing threat of competition in regulatory permissiveness on mergers. The Comptroller of the Currency has approved virtually every merger application filed with him for a long period of time, while the other two agencies have applied stricter standards. This might have led to an extensive switch to national charter, but for strong antitrust enforcement by the Department of Justice. The latter has in fact tended to equalize the "regulatory advantage" enjoyed by national banks in the merger area – and thereby avoid something which could be likened to a Gresham's Law of bad regulation driving out good. At the same time, the subject deserves further study not given it by the Hunt Commission; and, in particular, Chairman Wille's proposal for centralized regulatory authority in the merger area deserves study.[7]

[4]See LeDuc, "The FCC v. CATC, et al., A Theory of Regulators' Reflex Action," 23 FCC B.J. 93 (1969); Scherer, *Industrial Market Structure and Economic Performance,* (1970) 538-540; *Hush-A-Phone Corporation* v. *United States,* 238 F. 2d 266 (D.C. Cir. 1956). In the area of banking, Dr. Paul Horvitz has discussed these regulatory issues in a provocative article. Horvitz, "Stimulating Bank Competition Through Regulatory Action", *The Journal of Finance,* (March 1965), 9-10. See also Almarin Phillips, "Competition, Confusion, and Commercial Banking", *Journal of Finance,* 19 (March 1964), 39-41; Ross M. Robertson, "The Rationale of Banking Regulation", *Proceedings of a Conference of Bank Structure and Competition,* (Federal Reserve Bank of Chicago, 1970), 118-120.

[5]We had a rather interesting illustration of this point in connection with the pending Supreme Court case, *United States* v. *First National Bancorporation.* This is a potential competition case. In the trial court, the defendants offered evidence as to the prospects for new entry. The Comptroller's regional representative testified that he would not recommend and could not foresee a new national bank charter in Greeley. The state superintendent of banking was unwilling to take a position at trial, and within a matter of months authorized the formation of a new state bank by another Colorado holding company. See *American Banker,* June 2, 1972, p. 1.

[6]"The Bank Merger Act Revisited", Washington, D.C. March 26, 1971.

[7]"The Bank Merger Act Revisited", *supra.*

The Hunt Commission really did not face these underlying questions of policy in a detailed, analytic way. Nevertheless, they should be kept in mind as we discuss the specific questions of entry, mergers and concentration in banking.

*The Entry Question – Chartering and Branching*

It is trite but true that the conditions of entry are a key factor in industry performance.[8] It is equally true that entry into banking and into local banking markets has generally been held at a level below that which marketplace forces would have dictated.

The Hunt Commission would ease up on the restrictions to entry in two ways: first, the Commission would relax the degree of product specialization among banks and other depositary institutions; and, secondly, it would eliminate some of the existing geographic barriers. I am basically only considering the latter here.

The existing geographic barriers are extensive. Federal law prevents a bank or a bank holding company from operating bank offices in more than one state (12 U.S.C. 36; 12 U.S.C. 1842(d));[9] it gives the states a veto over bank holding company activities (12 U.S.C. 1846); and in the McFadden Act, it binds national banks to the same branching standard as the state banks in a particular state (12 U.S.C. 36).[10] Taken as a whole, this package represents a substantial deference to the states on the whole issue of entry. It is important because state law is very restrictive in many states. Fifteen prohibit branch banking altogether, while 16 others limit branch

[8]See Scherer, *supra,* 10, 216-218, 376-377; Phillips, *op. cit.,* 41; Bernard Shull and Paul M. Horvitz, "Branch Banking and the Structure of Competition," *Studies in Banking Competition and the Banking Structure* (The Administrator of National Banks: January 1966), 108-110.

[9]Of course, a very limited number of banks operated banking offices in more than one state at the time these restrictions came into force, and these operations were "grandfathered." In addition, a number of bank holding companies have "grandfathered" subsidiaries in more than one state; while additional acquisitions by the holding company are prohibited, the existing subsidiaries may branch or merge with other banks to the extent permitted by state law.

[10]The concomitant federal restrictions on savings and loan associations result from a combination of statute law and regulatory policy. Savings and loan holding companies are prohibited by statute from acquiring associations in more than one state (12 U.S.C. 1730a(c) (3)). Specific restrictions on branching are enunciated in regulations issued by the Federal Home Loan Bank Board.

banking to local markets. Still others provide "home office" protection to existing banks, and a few even protect branch offices in the same way. Finally, 11 states prohibit multiple bank holding companies by statute, and 5 others restrict them in lesser ways. As a result of these various limitations, only 12 states remain with both statewide *de novo* branching and freedom of holding company entry.

The Hunt Commission favors statewide banking. It recommends that "by state laws, the power of commercial banks to branch, both *de novo* and by merger, be extended to a statewide basis, and that all statutory restrictions on branch or home office location based on geographic or population factors or on proximity to other banks or branches thereof be eliminated." (Recommendation 6, pp. 61-62)

Needless to say, I embrace this recommendation with some enthusiasm. It is quite similar to what the Department of Justice recommended last year to the Council of State Governments – namely, that the states be urged to revise and liberalize existing restrictions on branching and holding company activity.[11]

The Commission does not discuss the underlying basis for its recommendation in great detail – but a strong case exists for it. The legislative limitations which the Commission and the Department were criticizing stem largely from a widespread fear of overbanking prevalent following the bank holiday of 1933. As I have indicated, those conditions are entirely different from those which pertain today. The case for reform is clearly stated by former Superintendent William Dentzer of New York. Talking about the situation in New York, he notes that "the most telling argument in favor of some modifications of existing law is that it offers the hope of increasing competition and the range of consumer choice for banking services in a number of communities throughout the State."[12] Moreover, "without major changes, new competition cannot readily be introduced into many markets. Such competition would provide bank managements with more challenges than they now face, the likely result being that the public would be better served." In criticizing his state's home office protection law, he notes the "anomalous situation" that, while designed primarily to protect

[11] Research Paper and Policy Statement of the United States Department of Justice Regarding State Legislation Affecting the Structure of Banking Markets (submitted under the Suggested State Legislation Program to the Council of State Governments, 1971).

[12] "Banking Structure in New York State: A Thinking Man's Guide to the Issues," Rochester, New York, October 15, 1970.

small banks in local communities, it serves also to protect some of the largest up-state banks with deposits in the billion dollar range.

I think Mr. Dentzer hits just the right tone. The concern of public policy should be to stimulate banking performance in the local markets, to provide the spur of competition. I fear that too often deliberations on law and structure have focused more on the interests of small banks than on the needs of small bank customers. Moreover, Mr. Dentzer's department has sponsored some interesting studies on the effect of large bank entry into markets they were formerly barred from. "These studies indicated that the profitability of small independent banks is not adversely affected either when large institutions entered the small bank's community by merging with one of the other small banks there or when new branches or larger institutions open near the home office community of these small banks. In both situations, to be sure, the rate of deposit growth of the small banks slowed down, although rarely was there any absolute decline in deposits."[13]

*Leaving Branching Policy to the States*

One feature of the Hunt Commission proposal that has attracted criticism is that the Commission would continue to leave branching policy, and holding company entry, in the hands of the states. Some would-be practitioners of practical politics say that there is very little opportunity for getting the necessary changes enacted at the state level, and that therefore the Commission should have opted for some form of federal pre-emption in this area. From a legal standpoint, this could be done – since Congress, by repealing the McFadden Act limitations on national banks, could easily have forced the states to follow suit. From a practical standpoint, however, I think such a course would be unwise. In some states, and I suspect Illinois is an example, there seems to be a strong and rather broadly held belief that big banks represent an evil that should be curbed. The spirit of William Jennings Bryan lives on. These are feelings that transcend notions of efficiency, and transcend the normal desire of banks to be protected from increased competition. The people in such a state should, in my view, be allowed to make the choice whether to have unit banking or not, even if the decision itself may seem to have a

[13] *Ibid.* He is referring to studies entitled: Ernest Kohn, *The Future of Small Banks,* The New York State Banking Department, December 1966, 12-19; Kohn and Carlo, *The Competitive Impact of New Branches,* The New York State Banking Department, December 1969, 8-9.

"horse and buggy" quality in the age of high speed computers and communications. Retail banking is most affected by these historic limitations, and at the same time retail banking is a largely local business; if local citizens want to make a local choice to stay with the past, and to possibly pay more for it, this is the choice they should be allowed to make. To summarize, I strongly endorse the Hunt Commission's proposals for liberalized bank entry into new geographic markets within a state, and I endorse the thought that it would be better done at the state level. In any event, repeal of the McFadden Act seems even less likely than reform at state level in many states – a point which is underscored by recent liberalizations of state law in New York and New Jersey.

*Interstate Banking*

The Hunt Commission never really faced up to the interstate banking issue. The report simply says in passing that: "Although the Commission rejected proposals to permit interstate branching or metropolitan area banking by federal legislation, it urges states to be progressive in changing their laws." (p. 62) I think this is a significant subject worthy of a great deal more consideration. On the broad question of interstate banking, I really have not seen enough evidence one way or another to convince me whether the existing prohibitions are wise or not. In the end, economics will probably not provide us with any final answers. Certainly the proven economies of scale in banking[14] are not such as to lead one to believe that wide open or even limited interstate banking is likely to substantially change cost performance in the industry. In the end, the case against wide open interstate banking may well turn out to be more political than economic – resting on the desire to avoid concentrations of political power and generally the type of banking structure found in England or Canada, where a handful of institutions dominate commercial banking in the country.[15] (I say this is a political issue

[14] *Cf.* F.W. Bell and N.B. Murphy, *Costs in Commercial Banking: A Quantitative Analysis of Bank Behavior and its Relation to Bank Regulation* (Boston: Federal Reserve Bank of Boston, 1968).

[15] That large banks already have substantial political power is an obvious reality – rather strikingly illustrated by the success of Manufacturers Hanover in obtaining special legislation (P.L. 89-356) to exempt it from the adverse antitrust decision in *United States* v. *Manufacturers Hanover Trust Co.*, 240 F. Supp. 867 (S.D.N.Y. 1965).

more than an economic one because I think that, even with interstate banking, the antitrust laws would be more than adequate to prevent the type of narrow concentration found in some of these foreign countries.)

*Metropolitan Area Banking*

I also believe that the idea of "metropolitan area banking" deserves more careful attention than the Commission apparently gave it. Geographic barriers can be highly arbitrary, especially when erected by circumstances centuries ago. Take, for example, the Washington Metropolitan Area, which includes the District of Columbia and parts of Maryland and Virginia. Banks and holding companies are basically confined to one of the three sectors. The boundaries that divide them date back to some 17th Century grants by English kings, to the creation of the original District of Columbia at the end of the 18th Century, and to the return of half the District of Columbia to Virginia in the mid-19th Century. Yet it is a common area, from the standpoint of business, media, traffic flow and so forth. In such circumstances, one can ask whether banking organizations should not be permitted – perhaps by the holding company route – to operate and compete throughout the whole metropolitan area. The question deserves serious study. I suspect that such a metropolitan approach would make for better banking competition in downtown Washington, as well as in the Virginia and Maryland suburbs. Somewhat similar situations exist in New York and Philadelphia, as well as in a few other metropolitan areas, mostly in the East and Middle West. I wish the Hunt Commission had given more study to this problem.

*Standards for Authorizing New Branches and Charters*

The Hunt Commission really did not detail the exact substantive standards which regulators should apply in authorizing new branches and charters. This is too bad, as the area deserves a great deal more careful thought. The F.D.I.C. has recently indicated that competitive policy is an important consideration in branching cases[16] – a position I agree with – but the statutes are less than specific on the point. Even amended Section 4(c) (8) of the Bank Holding Company Act, providing standards for the Federal Reserve Board to authorize

[16]F.D.I.C. Order Denying Application of Citizens and Southern Emory Bank to Establish a Branch, dated October 15, 1971.

banking entry into financially-related activities, is much more specific in telling the regulator what to consider. Specifically, the statute requires the Federal Reserve Board to consider whether performance of a particular activity by bank holding companies"... can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices."[17] You will note that the stress here is on benefits to the public, not on protecting competitors. This is important, and it is the kind of thinking that the Hunt Commission should have given its consideration to.

My own view is that the legal standards governing the granting of bank branches and bank charters should be more specific than most of these presently are; and, as with the amended Bank Holding Company Act, the focus should be on benefits to the public in the form of new services and so forth. I would favor more liberalized entry – at least in circumstances where no bank failures were threatening. Outside of the potential failure situation, I would do far more to leave it to the management as to whether the community is "overbanked" or not.

I would also consider writing into bank entry statutes a provision requiring the regulator to give preference to banks not already in a market in handing out branches and charters. This is contrary to the law or policy in some states (where the preference runs the other way),[18] but it seems to me to make considerable sense. Local banking markets are in most cases quite oligopolistic. Such oligopoly positions can to some extent be eroded if the leading firms in the local market are encouraged by law to go elsewhere for expansion and other banks are encouraged to expand within the market. The community with four banking offices, which is capable of supporting a fifth, is likely to be more competitive if the fifth office is awarded to a strong competitor not already in the market.

*Pre-Emptive Branching*

This last point is related to the problem of preemptive branching. An existing bank branch or charter really has two elements: first, it is a franchise doing business in the particular local market, and,

[17]P.L. 91-607, amending 12 U.S.C. 1843(c).

[18]See Purdon's *Penn. Statutes Annotated,* Title 7, Section 905 (b).

secondly, it is a means of excluding others from the market. Thus, a leading organization already in a banking market can on occasion foreclose new entry by applying first for all the new banking opportunities – even if this involves running uneconomic offices for a period. This difficult problem has been raised by the Federal Reserve Board in several cases involving the creation of new *de novo* subsidiaries by leading holding companies already in a local market. Thus, in 1968 the Board stated:

> "Inasmuch as entry into a commercial banking market is restricted, opportunities for deconcentration are limited. . . . If every newly developing need for banking facilities which arises in a concentrated market were to be filled by the market's dominant organization, any meaningful deconcentration of the market's banking resources would be made impossible, and further concentration might be encouraged."[19]

Similarly, in 1970, three dissenting Governors stressed that the establishment of a new bank by a dominant organization:

> "will perpetuate that dominance and foreclose an opportunity for the establishment of competitive facilities at Bank's location. . . . [A]nd much more significant benefits to the community would result from provision of such services by alternative sources. . . . Applicant controls 32 per cent of the deposits in Dane County. . . .[S]uch an organization, because of its ability to shift deposits from one office to another, may be capable of grasping an opportunity to establish a new office at a developing location long before it is economically feasible for others to take advantage of such an opportunity."[20]

The problem of pre-emption is even worse where the bank involved has secured some sort of exclusive right – typically in a shopping center or industrial park.[21]

[19] First Wisconsin Bankshares, 54 FED. RES. BULL., 645 at 647 (1968).

[20] First Wisconsin Bankshares, 56 FED. RES. BULL., 586, at 589 (1970), opinion of Governors Robertson, Brimmer, and Maisel.

[21] See complaint in *United States* v. *Wachovia Bank and Trust Co.*, Civ. C-135-WS-71, filed June 22, 1971 (involving an exclusive right to a night depository in a shopping center mall); and First National Bancorporation, Inc., 57 FED. RES. BULL. 47 (1971) (involving an apparently exclusive right in an industrial park).

The Hunt Commission does not really deal with this pre-emptive branching problem. Nor is there any clean straightforward solution. Regulators simply should be required to apply sound antitrust principles in passing on branch and charter applications – and antitrust law would prevent the truly dominant firm from acquiring new business opportunities before they become viable in order to foreclose them from others.[22] In addition, direct antitrust enforcement is a possibility, at least where the pre-empting enterprises enjoy some contractual type of exclusive right which restrains competition.

To summarize, the Hunt Commission's recommendations relating to bank entry are generally sound. I certainly endorse the Commission's proposals for eliminating geographic barriers and home office protection within the state. I also concur in the Commission's observation that dual control over entry is less likely to lead to protectionism of existing enterprises (see p. 60). At the same time, considerably more thought is needed on the whole issue of substantive standards which regulators should be required to apply in authorizing entry. The existing statutes are often too vague, and frequently fail to make clear that the overriding concern in this field is the needs and convenience *of the public* for banking services, rather than the convenience of the banks themselves. Competition is an important consideration, and this should be spelled out.

*The Concentration Question – And Merger Policy Generally*

The Hunt Commission did not seem to put great weight on "concentration" in its deliberations. This is perhaps just as well, since the concept of "concentration" is often subject to a great deal of loose usage – especially among us non-economists – in discussing bank structure questions. The concept is used at at least three levels – local market concentration, statewide concentration, and national concentration. At the price of parading my ignorance, let me give you my views on each of these concepts.

"Local" concentration in banking seems to me to be the most important. It is the economist's classic sort of market concentration: it is a means of measuring market position of competitors in the local service market in which they all operate. In banking, local concentration is generally quite high.

"Statewide" concentration will in most instances represent an aggregation of local competitive retail market positions. The results

[22] See *United States* v. *Aluminum Company of America,* 148 F.2d 416 (2nd Cir., 1945).

of such statewide aggregation vary greatly: in a few states, such as Oregon and Rhode Island, we can see that two banks dominate the state entirely, while in some other states a reasonable degree of diversity and choice exists even among the larger banking organizations.[23] In addition, statewide concentration may be an appropriate *market* measure of certain wholesale-type services offered on a statewide basis (such as correspondent banking or perhaps factoring).

"National concentration" is almost pure aggregation of local market positions. Of course, on a national scale, banking is a quite "unconcentrated" industry, with over 13,000 banks. Taking total bank deposits as a universe, one finds that the largest institutions in the country – although very large indeed – do not dominate the country. Thus, by my calculations based on December 1971 figures on domestic deposits, the nation's top five banks (with deposits of $67 billion) account for about 12 percent of national deposits; the top 10 (with deposits of $99 billion) account for 18 percent; and the top 25 (with deposits of $146 billion) account for 27 percent; and the top 100 (with deposits of $228 billion) account for 42 percent. Thus, the top 183 banks account for exactly half of all domestic deposits. In addition, there are a few national wholesale markets for large commercial borrowers and customers in which national concentration figures would be appropriate.[24]

The concentration question is important at at least two levels. One concerns the broad policy questions of structure – including statewide banking and indeed even interstate banking. The other concerns merger policy, and particularly antitrust enforcement in the merger area.

I have already generally discussed the legislative issue. I would note, however, that most of the use of concentration in this area is concerned with statewide or even national concentration. When the opponents of branch banking or holding companies scream out about "concentration", they are not talking about local markets – but rather are expressing concern about domination of a state or indeed the nation by the large money center banks.

On the other hand, merger policy in general, and antitrust merger policy in particular, have been primarily concerned with competition and concentration at the local level. Banking is always a local

[23]See "Recent Changes in the Structure of Commercial Banking," 56 FED. RES. BULL. 195-210 (1970).

[24]See *United States* v. *Manufacturers Hanover Trust Company,* 240 F. Supp. 867, 901-922, (S.D.N.Y. 1965).

business, and for larger banks it may often be a regional or national business. The antitrust laws and enforcement have stressed local markets because convenience is a vital factor for retail customers and local business; and effective choices are the most limited at the local level. Economic performance in local markets has often been quite poor, with the "quiet life" the order of the day. Thus, the District Judge in the *Phillipsburg* case summarized the situation in a passage noted by the Supreme Court:

> . . .most of the small banks in the area have not been interested in building up banking services except to the extent that aggressive competitiors led the way. An ultraconservative policy of banking seems to have been prevailing with reluctant change occurring only when profits and future growth were threatened by virulent competitors. There is an attitude of complacency on the part of many banks. They are content to continue outmoded banking practices service and extend services over a greater area to a larger segment of the population. 306 F. Supp 645, 661 (D.N.J. 1969).

*Antitrust Enforcement*

The Justice Department's often-controversial enforcement efforts are directed to this challenge. We have been actively concerned about anticompetitive local bank mergers, and have brought 26 cases against such transactions since 1966. (We have also been concerned over the years with anticompetitive arrangements between local bank competitors: these include price-fixing, cross-ownership arrangements, director interlocks, and "understandings" among the local bankers against poaching on each others' customers.) Our enforcement with respect to such local mergers has two elements: first, to prevent elimination of viable competitive alternatives, and secondly, to preserve the opportunities for new entry. The two policies are necessarily related in a state such as New Jersey where a "home office protection" statute prevents *de novo* entry, and hence new entry by a "virulent competitor" can only come by acquisition.[25]

Ever since the *Philadelphia National Bank* decision in 1963,[26] antitrust enforcement in banking has stressed concentration in local

[25]In states where holding companies are permitted, it may be possible to enter "closed" markets through *de novo* bank charters.

[26]374 U.S. 321 (1963).

markets. Section 7 of the Clayton Act represents a strong Congressional mandate that increases in market concentration which are created by merger are generally not to be tolerated. The Department of Justice and the Supreme Court have vigorously applied this policy of preventing local concentration. This policy applies in smaller markets which are usually more concentrated than large metropolitan ones. The Supreme Court was very clear on the point in its 1970 *Phillipsburg* decision: "Mergers of directly competing small commercial banks in small communities, are subject to scrutiny under these [antitrust] standards. Indeed, competitive commercial banks, with their cluster of products and services, play a particularly significant role in a small community unable to support a large variety of financial institutions."[27] The alternative, said the Court, "would be likely to deny customers of small banks – and thus residents of many small towns – the antitrust protection to which they are no less entitled than customers of large city banks. Indeed, the need for that protection may be greater in a small town. . ." where the alternative institutions are more limited.[28]

So much for local concentration. The antitrust rules add up to a strict test. As Chairman Wille of the F.D.I.C. said in a speech last year, "It is unlikely that many mergers of viable banks already competing in the same market can be justified" under the *Phillipsburg* standard.[29]

The Hunt Commission did not really deal with this problem of local concentration in any detail. Nor, as I see it, are there any real reasons for them to have done so, for so far as mergers are concerned, the situation is under reasonable control. What is required – and what we may continue to expect – is continuing vigorous enforcement by the Department of Justice in this area.

Concentration – or more accurately dominance – at the statewide level is something that has been a matter of growing concern to the Department of Justice. Here, however, we are not talking about concentration in a real market sense so much as the elimination of potential competition into local banking markets within a state. The state boundaries are of course significant to competitive analysis in banking, because they delineate the widest area from which potential

[27] *United States* v. *Phillipsburg National Bank,* 399 U.S. at 358 (1970).

[28] 399 U.S. at 361-2 (1970).

[29] "The Bank Merger Act Revisited," *supra* n. 6.

competitors can be drawn. I am therefore concerned when I see a trend in a state in which the leading banking organizations move on to a position of statewide dominance by acquiring the leaders in local banking markets throughout the state. In most of the states where the Department has brought suit, there were only a handful of banks or holding companies which could enter a market *de novo* or by a small "toe hold" acquisition, and from the outset be a competitive force to be reckoned with in that market. Any time one of these few significant potential entrants enters a concentrated local market through acquisition with the local market leader, then that loss of potential competition is likely to occur. Therefore, the Government argues that a Section 7 violation can be found in a bank merger case if the Government proves that (1) the acquiring defendant is one of but a fairly small number of capable potential entrants legally eligible to enter a market; (2) the acquired bank is a leader in a concentrated local market; and (3) the acquiring defendant has an alternative means of entry (e.g., either the market is growing fast enough to support additional banking facilities *de novo* now or in the future or a small competitor is present in the market as an entry vehicle).

I think that this approach is particularly appropriate in commercial banking. There are several considerations here. First, the availability of potential entrants is limited by law: no bank or holding company can enter a state from the outside. This necessarily limits the number of significant potential entrants and makes potential competition even more important. Secondly, all potential entrants are not equal in banking: the large, strong bank has a higher legal lending limit than the smaller bank, and therefore can compete for a broader range of customers; it may offer a wider range of services and may have other advantages as well. This gives it a better chance than a smaller potential entrant to challenge, as a *de novo* or foothold entrant, the leaders in the local banking market. Thirdly, the barriers to entry and full competition imposed by law and regulation make it more important – not less important – to preserve the opportunities for future competition. If a few large, strong banks come to entirely dominate banking throughout a state – as in Oregon – no relief from the outside is available except in the very, very long term, and perhaps not even then. One does not suddenly establish a new billion dollar bank as if it were a hot-strip mill or a Caribbean resort complex. In these circumstances, the strongest banks in a state (if relatively few in number) should be preserved as challengers to local market leaders – rather than being permitted to accumulate a position of overall dominance through piecemeal acquisition of local leaders.

This approach to the statewide "concentration" problem is very much at issue in the *First National Bancorporation* case, which the Supreme Court will decide next Term.[30] That involves the acquisition by the largest bank in Denver of a leading bank in one of the larger local markets of the state. At the time the case was filed, the same defendant had a number of other pending proposals in most of the other leading Colorado markets. The importance of this case is underscored by the fact that both the Federal Deposit Insurance Corporation and the New York Superintendent of Banks have filed *amicus* briefs supporting the use of the potential competition standard in commercial banking.

In at least one recent antitrust case, statewide markets have been directly alleged particularly for certain wholesale services. The complaint in the pending *Wells Fargo* case includes allegations of increasing statewide concentration in banking, correspondent banking and loans to medium-size businesses.[31] Generally, however, as I have indicated, statewide markets in a strictly economic sense have not been a great factor in antitrust cases.

National market figures have not really played any significant role in antitrust enforcement. Defendants in antitrust cases – including the *Philadelphia* and *Houston* cases – have frequently asserted that they needed to engage in horizontal local mergers in order to effectively compete on a "national" or "international" basis. The courts and the Department have generally rejected this plea on two grounds. The "national" wholesale market is generally better served and has more competitors than local retail markets, and therefore this does not provide a basis for upholding anticompetitive local mergers. Moreover, in the *Philadelphia* case, the Supreme Court stressed that alleged procompetitive effects in one market were not a justification for allowing anticompetitive effects in another.[32] Quite apart from

[30] *United States* v. *First National Bancorporation,* No. 71-703, decided by the District Court in favor of the defendants, 329 F. Supp. 1003 (D. Colo. 1971).

[31] *United States* v. *Wells Fargo Bank, et. al.,* (D.C.N.D. Cal. CA No. C-72-98 RHS filed Jan. 17, 1972). It should be noted that this case involves two banks which compete directly in many parts of the state. In the *First National Bancorporation* case, *supra,* there is an allegation of vertical foreclosure in correspondent banking in a market which included all of Colorado. In the *Marine Bancorporation* case in Washington State, there is an allegation of elimination of actual and potential competition in correspondent banking in an eastern Washington market. *United States* v. *Marine Bancorporation et al.,* (D.C.W.D. Wash. CA No. 237-71 C2, filed October 22, 1971.

[32] *United States* v. *Philadelphia National Bank,* 374 U.S. 321, 371 (1963).

the question of law, this seems sound as a matter of policy so long as an adequate level of competition exists in the first market, for surely it is the need of the banking public for service and not the desire of particular banks to participate in the market which should be the controlling issue of policy.

There has also been a certain tendency among defendants and commentators to mix up concentration at national and local levels in order to justify mergers. This is a real case of apples and oranges. The argument runs that we have "too many" banks in this country, and therefore we ought to be hospitable to some consolidation by merger. This argument is fine so far as it goes, but it ignores the fact that, even if we have "too many" banks on a national basis, we have too few banks in most local markets. What I am suggesting is this: there is no reason not to have some rationalization of banking structure so long as one does not eliminate significant local alternatives – in other words, so long as the mergers involve parties in different markets, while avoiding any threat of statewide (or national) dominance.

To summarize, I think that concentration in banking is a matter of serious concern at the local level because it is here that market choices are limited. On the statewide level, there should be concern, because statewide "concentration" can lead to important reductions in potential competition. On the other hand, "concentration" on a national basis is really not at this time a pressing policy problem.

*Conclusion: Antitrust and Reform*

The Hunt Commission would increase competition among banks and other depositary institutions in a number of ways. This is highly desirable, as a means of improving efficiency.

The Commission's proposals, if adopted, would be significant for antitrust enforcement. As you know, antitrust enforcement has clearly been active in banking. The Department has brought over 50 bank merger and holding company cases since 1966. There are several reasons for vigorous enforcement in this area. First, the depositary and credit functions are vital to our economy. Second, the Department and the courts recognize the basic truth stated by the Supreme Court a decade ago: "The fact that banking is a highly regulated industry critical to the Nation's welfare makes the play of competition not less important but more so."[33] Third, local banking

[33] *Philadelphia National Bank,* 374 U.S. at 372.

markets are often already protected by existing legal barriers from full competition – competition from commercial banks in other geographic areas and from other types of institutions.

Enactment of the Hunt Commission proposals would open up some of these classic preserves and thereby reduce, to some degree, the need for such extensive enforcement in this field. For example, if the nation should adopt the Commission's proposals to eliminate the existing barriers between commercial banks and thrift institutions, the antitrust analysis of bank mergers would have to change to accommodate this reality – specifically by including at least the growing demand deposits of thrift institutions in any market analysis.

Similarly, the elimination of home office protection and other geographic barriers to entry into local markets might lead to somewhat greater flexibility in approaching certain horizontal mergers in those areas. Under present law, a horizontal merger between direct competitors may permanently reduce the number of effective (or potentially effective) banking alternatives available in a community. *Phillipsburg* offers a good illustration. New Jersey law has a home office protection feature, which means that no other bank could branch into Phillipsburg *de novo.* Thus, after the merger between its two largest banks, there would be two banks in Phillipsburg and the only hope for new entry appeared to be a new charter. The opportunities for the market-place correcting anticompetitive power are particularly limited under any "home office" protection type of statute, and, therefore, a merger between two local banks is a much more serious proposition than a merger between two local supermarkets[34] – for the merged supermarket would still always have the threat of unregulated new entry if it abused its market position.

I mention this all by way of an added incentive – if any is necessary – for all of us to look with care at these proposals for reducing some of the historic barriers to competition in banking.

[34]But cf. *United States* v. *Von's Grocery,* 384 U.S. 270 (1966).

# DISCUSSION

ROSS M. ROBERTSON*

I speak this morning as an alumnus of both the Federal Reserve System and the Office of the Comptroller of the Currency. As I sat here and heard the Comptroller's Office subtly maligned, you can imagine how I reacted to this particular commentary. I must say that I had a feeling as I read Donald Baker's paper that I was being dealt with by Peter Falk's TV character Detective Columbo – that is, there is a certain self-effacement about his knowledge of economics and history and business that is, to say the least, deluding. But don't kid yourselves. Don Baker is knowledgeable, like his colleagues in the Antitrust Division of the Justice Department generally. He is four-square for maintaining competition in the economy, whatever that may be, and the paper, as I read it, is superficially very persuasive indeed. In other words, it is written by a man who is knowledgeable, not just about the law but about economics, and he knows his history. Straight off I will just say that my objection to his paper is that, like those who take a vigorous antitrust position generally, he picks and chooses. He seems to applaud the Hunt Commission Report insofar as it is on the side of competitive processes; yet he refuses to face up to the logical outcome of competition, which is, in finance in any case, large units and often very large units indeed, perhaps ultimately a dozen great banking systems in this country.

*Banking Concentration*

As I see it, Mr. Baker takes this latter view of the regulatory problem, particulary with respect to concentration and especially

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concentration through merger. He sees no problem in the national market, and I applaud this view. He did not cite his statistics, but they are very clear. If you take the top 50 or the top 100 or the top 200 banks in the country, you will find that since the middle-1950s the percentage of the total banking assets controlled by that specific number has been gradually decreasing – to take the example of the top 100 banks in the country, from about 55 percent of total assets in the mid-fifties down to about 43 percent in 1971.

*Liberal Bank Entry*

Second, Mr. Baker endorses liberalized bank entry into new geographic markets within a state, which certainly goes along with the Hunt Commission recommendations. But it is interesting that he becomes extremely ambivalent toward any kind of extension of a single bank's operation across state lines. At first he says he thinks they ought to be confined to the states – and here I want to read from the paper, for this is the kind of prose that really moves a man. He says that "in some states," – and I suspect Illinois is the example – "there seems to be a strong and rather broadly held belief that big banks represent an evil that should be curbed. The spirit of William Jennings Bryan lives on. These are feelings that transcend notions of efficiency and transcend the normal desire of banks to be protected from increased competition. The people in such a state should, in my view, be allowed to make the choice of whether to have unit banking or not. Even if the decision itself may seem to have a horse-and-buggy quality in the age of high speed computers and communications." He goes on to say "retail banking is most affected by these historic limitations. If local citizens want to make a local choice to stay with the past and to possibly pay more for it, this is the choice they should be allowed to make." For this kind of talk we have a two-syllable expletive out in the Midwest that I am not going to use here because of our mixed group, but I should like very much to use it. The reason no branching is allowed in the state of Illinois has not a damned thing to do with what people out there want. It is the consequence of political shenanigans on the part of little banks in southern Illinois that, as a consequence, have made the Continental-Illinois National Bank and Trust Company the largest bank under one roof, or adjacent roofs, in the whole country. It is patent nonsense to say that the people of Illinois want this kind of banking structure.

### *Branching in Trade Areas*

But I wish to get on to the point that I really am concerned about, one that the Hunt Commission did not consider. Don Baker raised the question, which must occur to anyone who thinks about U.S. banking structure – should commercial banks be allowed to branch in trade areas? Now this idea, I assure you, is not a radical notion. Comptroller Pole, who was the Comptroller of the Currency under that flaming liberal, President Herbert Hoover, made this suggestion some forty-odd years ago. Comptroller Pole said that we should have branching over trade areas within a radius of 50 miles, and I think this was then and is now a good idea. Now trade-area branching is no small matter of course. Once you open this door, not just in Washington, D.C., where it has recently been set ajar, but in New York City, Chicago, and so on and on, you have the problem of branching across state lines. I personally think that it is just a matter of time until permissive legislation along these lines is forthcoming. In any case, it is one of the matters that Congress must one day consider should the Hunt Commission Report and its general recommendations be put in the form of a bill.

### *Freer Competition*

I could carry on with this theme for hours, but I know that you as conferees want to get in the act, so I must close quickly. I think that the Hunt Commission Report is in the shape of the future in that it frees up the competitive process tremendously by bringing the nonbank intermediaries into closer competition with commercial banks. I should also like to say that, no matter what we decide in this present generation, the ultimate outcome of competition is large units. We have historical and theoretical reasons for making such a prediction, and I think we should get ourselves into the shape of the future sooner rather than later.

Let me make a few specific points. The dual banking system is a sheer historical accident. Congress clearly outlawed it in 1865. If the legislation of 1865 had come a decade earlier, there would be no such things as state banks. That is to say, the 10 percent tax placed on state bank notes in 1865, as most of you know, was intended to force state banks to convert to federal charters, and it got all but about 300 of them to do so when, lo and behold, those few held on because by that time note issue was no longer important, at least for larger banks in sophisticated money centers. I would next point out

that the proscriptions against branching in this country are the consequences of the sheerest historical mischance. There is no evidence that the framers of the 1863 and 1864 legislation meant to preclude branching of national banks. Freeman Clarke, immediate successor to Hugh McCulloch as Comptroller of the Currency, ruled that the 1864 statute requiring persons forming an association to specify *the* place where business would be carried on meant just that – singular. On the basis of this wording, which had nothing at all to do with the branching question, he ruled that national banks could not have branches, and so for a long time the question of branching remained controversial.[1] We almost had branching freed up by the federal government in 1932 as the most commonly advocated proposal for strengthening the foundering American banking system; but once again the small banks in the country bought off legislation that would have made branching completely free, not only intrastate but across state lines, by suggesting a plan of deposit insurance as an alternative way of shoring up the unit banking system.

*The Theory of Oligopoly Structure*

I could carry on for hours in demonstration of the historical proposition that there has never been widespread political or economic opposition to increased concentration in banking, but I want to say a word about the theory. The theory of oligopoly structure is well known to everybody in this room; there is no need for me to go into it. Our speaker, Mr. Baker, cites local banking markets – which are the markets that concern him – as being typical oligopoly markets. Well, oligopoly theory tells us that if you have a few sellers in a market, say three or four, the price and output results of adding one more are approximately the same as they would have been if you had not added the one in the first place. That is to say, we should expect oligopoly-structured markets to exhibit some elements of monopoly control so that, even without explicit collusion, prices of particular services will be somewhat higher than under conditions of perfect competition. By the same token, if public policy allows the economies of scale that large units provide, even with some monopoly elements of pricing, you are likely to have lower prices and better service to consumers than you are in an

[1] For the historical details see Ross M. Robertson, *The Comptroller and Bank Supervision* (Washington, D.C., Office of the Comptroller of the Currency, 1968), esp. pp. 81-85.

atomized industry. Here again is a major question with which all of us must be concerned.

Let me just make one more point. Historically the outcome of competition is clear. As of the end of 1971 multi-bank holding companies controlled more than a thousand commercial banks representing roughly 20 percent of banking resources in this country. Believe it or not, as of 1962 nearly 2,300 commercial banks or about 17.5 percent of the total number holding 19 percent of total deposits had a chain affiliation. (Chain banking bears examination in this decade, because the last time anybody looked was in 1962, and our data are old.) Two-thirds of the banking offices and more than 70 percent of banking assets are already under the control of branch systems. The United States is no longer a country typified by unit banking, except, as our chairman euphemistically put it, in the Heartland, where benighted legislators refuse to get into the twentieth century.

*Regulation by Antitrust?*

I must say a word or two in conclusion about the very last part of Don Baker's paper. This is where the punch comes. You can skip over all that smooth talk you get in the first 20 pages, and when you come up right to the end it is clear that Mr. Baker feels that the saving grace in this whole question of regulation is the Antitrust Division of the Justice Department. Now, I am going to say something that is going to start a row, but I am comforted by the reflection that the function of speakers at a conference is to start the talk going. The Justice Department really has no business interfering in the regulation of banking in this country. Here I wish that I were an attorney and could comprehend a little better the obscure wording of decisions in such cases as *Philadelphia National Bank* and *Houston.* I could then understand a little better how it is that, in its efforts to prevent mergers, the Justice Department can proceed under Section 7 of the Clayton Act and just forget all about the intent of Congress as expressed in the Bank Merger Acts of 1960 and 1966. I insist that if Congress had wanted to bring banks under Section 7 of the Clayton Act, it would have done so in the Celler-Kefauver Amendments to the Clayton Act, which carefully omitted banks from their application. It is my belief that Congress intended, particularly in the Bank Merger Act of 1966, to allow the Justice Department to intrude only in flagrant cases of merger approvals by federal banking agencies. Of course, Don can respond that all of the

Comptroller's approvals have been flagrant – but it seems to me that twenty-odd objections is a little much. So I close in concurrence with at least one point that Don made and that is that we should have deregulation, a lot of deregulation, and the first step should be to get the Antitrust Division of the Justice Department out of it.

## DISCUSSION

LEONARD LAPIDUS*

It is true, as Don Baker remarks, that we haven't had terribly good luck with our monetary commissions in recent years. The Commission on Money and Credit and the Heller Committee were notably unsuccessful in effecting significant changes in our financial institutional arrangements. By contrast, the only other monetary commissions to be formed in the United States were responsible for the establishment of the Comptroller's Office and national banking system, and the Federal Reserve System. While neither of these social institutions is without its detractors, their existence alone is witness to the virility of the commissions that fathered them.

Indeed, the success of a commission in having its recommendations implemented is one measure of its value. Clearly, the other measure is whether its recommendations are "good" – in the present case, whether the Commission's recommendations provide significant public benefits. Let me discuss both points briefly.

*The Role of a Commission*

We misconceive the role of a commission. We seem to treat its report as the product of a group of philosophers. Oliver Wendell Holmes said that it would take no more than two hours for two philosophers to tell one another all they know. The hours of deliberation of the Hunt Commission suggest that its members were not telling one another what they knew but rather what they wanted. Commissions of this sort, in fact, are established to resolve pressing problems in a way that is acceptable to relevant interest

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groups. A commission's recommendations should represent a zone of agreement — in effect, a handshake convenant arising out of tough, self-interested bargaining.

That a commission's proposals in fact are implemented is an indication first, that the commission was probably properly constituted — that its members represented the proper cross section of significant interest groups. And second, that the members reached a realistic *modus vivendi* to such an extent that legislators were able to frame laws, or administrators to promulgate regulations, without arousing significant opposition from any of the constituencies represented on the commission.

In other words, if you want wisdom, ask a wise man. If you want a "do-able" program, at least one way is to establish a commission.

### *The Public Interest*

What about the public interest? The public interest should also be at the bargaining table — generally in the persons of public members who are not necessarily wiser than others but simply without a clear stake in the outcome. The public is a party at interest (though oft times not an interested party), and it should get its fair share of the bargain. But, clearly, as only one of the parties, the public interest is not likely to be served as well as it might be. Thus, commission reports generally fall short of providing maximum public benefit, but we often accept their recommendations if the public interest is served "well enough." Perhaps "well enough" is the only public benefit standard that can realistically be used in appraising the reports of monetary commissions.

We might first ask, does the Hunt Commission report represent the kind of compromise agreement that Congress can count on to have the support of the relevant interest groups? I think the answer is no.

### *Inadequate Representation for Small Banks*

As I read the report, the views of small commercial bankers — though represented at the table — are not represented in the final recommendations in proportion to their political influence. Mandatory membership in the Fed affects small banks the most. On the other hand, the primary gains of commercial banks are in the new flexibility in the composition and management of loan and investment portfolios and in the acquisition of funds from non-deposit sources. These benefit large banks, not small ones. Also, the

benefits of statewide branching, such as the Commission favors, will be gained in part at the expense of small banks. Indeed, perhaps the only comfort small banks may take is that "it could have been worse." At least the Commission did not recommend the repeal of the McFadden Act and the termination of the prohibition of interest payments on demand deposits. Donald Carlson, the Investment Bankers Association of America's outgoing president said, in truth, ". . . there is nothing in this report for us, but something for everyone else." The failure of the report to serve the small banks an acceptable share of benefits is bound to weaken the chances that the report will be implemented in anything like its present form.[1]

More generally, the report can be best understood, it seems to me, if one thinks of it as a compromise agreement between the large commercial banks and the thrift industry. The proposals that are at the heart of the compromise are happy ones. These are essentially the broader asset and liability powers for all institutions and the elimination of Regulation Q – all likely to sharpen up competitive tempers and improve the quality of service in household markets. But note again that the major negative impact of enhanced thrift powers falls on small commercial banks whose retail business represents a much more important part of their business than it does of the business of large banks.

Once past these proposals, one sees evidence of the massing of the regulated in common cause to support proposals of mutual benefit and to support one another when such support is not self-defeating. Consider, for example, the proposals on regulatory structure.

*Proposals on Regulatory Structure*

Multiple jurisdiction at the Federal level was confounded with still another agency; the Fed, the agency that over the years has been the most sensitive to competitive issues, was removed for the most part from regulatory responsibility. Indeed, the single responsibility left to it, the interpretation of the Holding Company Act, was seriously undercut by proposing that depositary institutions might engage in activities that the Fed permits to holding companies. (For thrift institutions, these activities might be offered only to individuals and nonbusiness entities.) This would leave in the hands of each of the primary supervisors the authority to interpret Fed regulations and

[1] See the closing remarks of Donald Jacobs and Almarin Phillips, p. 19, for a contrasting view.

thereby establish still another opportunity for the regulated to play one regulator against another. Except now the thrift institutions would also be in the game.

The "structure" proposals are of much the same character. The Federal chartering of mutual institutions is still another device for weakening regulatory control. Also the Commission importunes the states to allow statewide branching for depositary institutions but speaks in a much softer voice when encouraging chartering authorities to charter more freely in a way that would increase competition. There is more concern shown for the needs of existing bankers than for potential bankers. Indeed, the appeal to the states is no more than a piety. If the Commission were interested in strengthening competition significantly, it could have proposed the repeal of the McFadden Act which at one stroke would lay the groundwork for a competitive nationwide financial system.

The proposal to eliminate Regulation Q is pro-competitive, but why did the Commission hesitate to recommend ending the prohibition of interest on demand deposits? This, too, is a regulated deposit interest rate ceiling that happens to be set at zero. I would guess because now that thrift institutions would have checking account powers, there was no reason to give up an advantage from which all could benefit.

All this is to say that the Commission could have made more competition-stimulating proposals. But as I indicated, the fair question to ask is, did the Commission do "well enough" in furthering the public interest? And I again agree with Don Baker that the report offers us "an improved model of the status quo rather than a grand plan for the next generation" but there are worthwhile improvements for all that.

With respect to the structure proposals, I trust I have indicated that the Commission should have been bolder and perhaps doesn't deserve all the praise it has received for its good thoughts in recommending statewide branching. Nevertheless, the failure is not as damaging as it might appear. The social and economic forces are rapidly eroding the effects of restrictive structure laws. To name a few: the Supreme Court in its one man-one vote ruling has drained power from rural areas whose bankers are most opposed to liberalized structure laws. This increases the likelihood that we shall in fact see more positive action at the state level. Second, the holding company movement: we shall see interstate penetration by nonbank subsidiaries performing near-banking activities. Also, about two-thirds of the states allow holding company formation and once the

holding company expansion in a state results in effective statewide penetration, the objections to statewide branching dissolve. We see this beginning to happen in New Jersey.

*Wider Banking Markets*

At the same time there are forces that are making for widening banking markets. In the future, we shall be less dependent on convenient location and that undercuts the significance of restricted entry. Electronic banking – the instant debiting and crediting of accounts – is hardly widespread but we can see the shape of the future. Pre-authorized loan lines for consumers – credit cards, check credit and the like – make locational convenience less important. The growth of urban areas in many places has eliminated the value of home-office protection. The population often has grown beyond the limits of the politically defined area to which home-office protection applies. And now center-of-town locations are often not the best ones. Indeed, the growth of the suburbs in the postwar period brought city banks and suburban banks into competition because commuters might choose between their "near-work" banks and their "near-home" banks. Suburban growth, of course, was also an important stimulus toward liberalizing structure laws to allow city banks to branch out to follow their customers.

Turning specifically to Don Baker's paper I find his reaction to the report ambivalent. He likes its direction but not its distance – and yet his own deep commitment to stimulating competition seems also to be guided by practical expediency and his resolve frequently falters.

For example, he says that the Commission did not examine closely the questions of why we regulate bank structure and how should it be done. While he asks the questions, he does not provide answers that would have formed the basis for his own reaction to the report. But he suggests answers that should have made him more critical of the report as insufficiently concerned with competition. He suggests, for example, that bank structure regulation is perhaps primarily for the purpose of preventing bank failures and protecting weaker competitors. He goes on to say that neither purpose is any longer valid. If logic will out, it seems that he would take a position in favor of "free-banking" – and if that is the position from which Don views the Hunt Commission report, he could not be as kind as he is.

Don's support for the McFadden Act is particularly puzzling considering his endorsement of at least limited interstate or metro-

politan area banking. To leave this to the states suggests very slow progress even in its consideration. Also, his argument in favor of retaining the McFadden Act is not convincing. I respect his sensitivity to the populist convictions of the people of Illinois and might even accept an argument based on expediency but the argument that it is only local banking competition that will suffer subverts the philosophy of the *Phillipsburg* case. I shall hoist him on his own quotation from the 1970 *Phillipsburg* decision:

> "Indeed, competitive commercial banks, with their cluster of products and services, play a particularly significant role in a small community unable to support a large variety of financial institutions." The alternative, said the Court, "would be likely to deny customers of small banks – and thus residents of many small towns – the antitrust protection to which they are no less entitled than customers of large city banks. Indeed, the need for that protection may be greater in a small town. . ." where the alternative institutions are more limited.*

His suggestion that entry statutes should contain positive language that would give chartering and branching preference to new competitors is a good one. It is a recognition that the statutes should begin to accept a regulatory philosophy that stimulates competition subject to a bank safety constraint and not the other way around.

Let me also suggest that the considerations that guide our decisions on the merger of potential competitors stand in need of greater competitive thrust. Don outlines the three conditions required to find a Section 7 violation in a bank merger case:

> "(1) the acquiring defendant is one of but a fairly small number of capable potential entrants legally eligible to enter a market; (2) the acquired bank is a leader in a concentrated local market; and (3) the acquiring defendant has an alternative means of entry (e.g., either the market is growing fast enough to support additional banking facilities *de novo* now or in the future or a small competitor is present in the market as an entry vehicle)."†

I would add as a consideration, whether there are a reasonable number of banks that are probable purchasers and preferable as merger partners. Someone will say that I am suggesting that the bank

*pp. 27-8. Baker's citations for the quoted opinion are 399 U.S. at 358 (1970) and 399 U.S. at 361-2 (1970), respectively.

†p. 30.

supervisor or the Department of Justice should "play God." But if size and share of the market are indexes of the strength of a bank as a potential competitor, shouldn't we attempt to increase the competitive strength of less dominant banks by "saving" attractive acquisitions for them? A policy of this sort would, for example, increase the number of strong potential competitors in a state and enhance competition in all markets in the state. In other words, competitive issues in a particular case relate not only to the single market involved but all other markets where acquiring banks are eligible to enter.

Don takes a much more aggressively pro-competitive view on preemptive branching. Preemptive branching by a dominant competitor, he argues, should be carefully policed. In effect he would "save" attractive locations for smaller – and therefore preferable – banks. The argument for "saving" attractive acquisitions for smaller – and therefore preferable – banks is, in my view, even stronger.

*Concentration Ratios*

Just a final short word on "concentration ratios." The kinds of concentration ratios one can easily calculate from published figures should be used very carefully. They can't be given fixed meanings. The larger the geographical area covered, the less certain they have any meaning. Concentration ratios for carefully defined markets are useful. Local areas come closest to being true banking markets and concentration ratios may be useful. However, state and national figures are treacherous. Don indicates that statewide figures have three uses. They can suggest whether a reasonable degree of choice exists within a state's borders; they are an appropriate market measure of certain "wholesale type" services offered on a statewide basis; and finally the share of state market may be a measure of the strength of a potential competitor. None of these propositons holds up very well. First, where customers search for, or find, banking alternatives is not usually related to state lines. Also, markets are not apt to follow state lines even for services offered on a statewide basis; out-of-state banks may offer services over state lines. Finally, share-of-market figures are so affected by the structure laws in a state that their use as indexes of potential competitive strength is not recommended.

The treachery of state figures is evidenced by the case of New Jersey prior to the 1969 change in that state's structure laws. The

state ranked among the half-dozen least concentrated states in the nation, largely because branching and merging were limited to county lines. County concentration ratios were very high. The low statewide ratios for the leading banks did not mean that New Jerseyans had wide choices. Also, because of the happenstance of the county of location, a bank's share of state deposits might be a poor indication of how aggressive a competitor it might have been if merging and branching opportunities had been available.