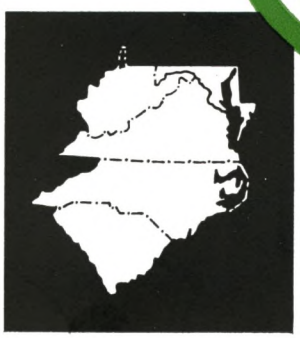
FEDERAL RESERVE BANK OF RICHMOND

MONTHLY REVIEW

Antitrust and the New Bank Holding Company Act

The Fifth District

Agricultural Outlook for 1971



APRIL 1971

Antitrust and the New Bank Holding Company Act: Part III

As discussed last month, new antitrust rules governing bank holding company acquisitions of banks became effective in 1966. At that time, there were but 65 regulated companies controlling two or more banks, and their deposits accounted for only 11.6 percent of total bank deposits in the United States.

By mid-1970, however, regulated companies accounted for 16 percent of total deposits, largely because 44 new companies were formed in the intervening period and the number of banks in regulated groups increased from 561 to 884. Although prior approval under the new antitrust rules was required for both holding company formations and for bank acquisitions throughout this period, only two approvals by the Board were challenged in court by the Department of Justice under the antitrust laws.[1]

Meanwhile, controversy erupted over the growth of unregulated one-bank holding companies and their expansion into a variety of nonbanking businesses. Under the 1956 Bank Holding Company Act, as we have seen, companies controlling *two or more* banks were required to divest most of their nonbanking activities of they chose to retain control over their banks. However, no restrictions were placed upon nonbanking activities of companies controlling only a *single* bank.

The One-Bank Holding Company Exemption

From the legislative reports, it appears that Congress excluded one-bank holding companies from regulation for three principal reasons. First, since only one bank was involved, the holding company could not be used to evade Federal and State branch banking legislation. Second, most of the banks owned by one-bank holding companies were small. And third, the nonbanking activities of these companies were for the most part quite limited involving, primarily, local real estate and insurance agency operations. The only legislative comment shedding light on the 1956 exemption for one-bank holding companies was the following paragraph of the Senate Report:

> Your committee did not deem it necessary to include within the scope of this bill any company which manages or controls no more than a single bank. It is possible to conjure up visions of monopolistic control of banking in a given area through ownership of a single bank with many and widespread branches. However, in the opinion of your committee, no present danger of such control through the bank holding company device threatens to a degree sufficient to warrant inclusion of such a company within the scope of this bill. Should legislation of that nature prove desirable in the future, the Congress is free to act upon a showing of need for such a law.[2]

Nevertheless, the Board consistently urged Congress to include one-bank holding companies, both before and after adoption of the 1956 legislation. In 1953, Governor Robertson asserted to the Senate Committee on Banking and Currency that

> If there is merit in the proposal that you should separate banking from nonbanking businesses, it is just as important that you do it in a 1-bank case as in a 2- or more-bank case.[3]

In 1955, testifying before the House Banking and Currency Committee, Chairman Martin stated:

> . . . it seems clear that the potential abuses resulting from combination under single control of both banking and nonbanking interests could easily exist in a case in which only one bank is involved. In fact, if the one controlled bank were a larger bank, the holding company's interests in extensive nonbanking businesses might well lead to abuses even more serious than if the company controlled two or more very small banks. For these reasons, the Board would continue to urge that, whatever the percentage test may be, the definition should be related to control of a single bank.[4]

When the 1956 Act became effective, there were about 117 unregulated one-bank holding companies with total deposits of $11.6 billion,[5] compared with 42 regulated companies having aggregate deposits of $15 billion.[6] Over the next decade the number of one-bank holding companies increased to about 550, but their combined deposits rose only $3.5 billion, to $15.1 billion. The relatively small deposit increase reflects the fact that most of the new companies were small, local enterprises. In contrast, over the same period deposits of regulated holding company banks almost doubled, from $15 billion in 1956 to $27.6 billion at the end of 1965. When

[1] *U. S.* v. *First at Orlando Corporation et al.*, filed December 23, 1969; *U. S.* v. *United Virginia Bankshares*, filed January 30, 1970.

[2] "Control of Bank Holding Companies," Committee on Banking and Currency, United States Senate, 84th Cong., 1st Sess. (1955), p. 7.

[3] "Bank Holding Company Legislation," Hearings Before the Committee on Banking and Currency, United States Senate, 83rd Cong., 1st Sess., on S. 76 and S. 1118 (1953), p. 14.

[4] "Control and Regulation of Bank Holding Companies," Hearings Before the Committee on Banking and Currency, House of Representatives, 84th Cong., 1st Sess., on H.R. 2674 (1955), p. 15.

[5] "The Growth of Unregistered Bank Holding Companies—Problems and Prospects," Staff Report for the Committee on Banking and Currency, House of Representatives, 91st Cong., 1st Sess. (February 11, 1969), p. 5.

[6] Hall, "Bank Holding Company Regulation," *Southern Economic Journal*, v. 31, (1965), p. 34.

Congress in 1966 again faced the issue of regulating one-bank holding companies, it again declined to do so because ". . . there was no substantial evidence of abuses occurring. . . ."

One-Bank Holding Company Growth, 1966-1970 A radical change in the nature of one-bank holding company growth and activities occurred after 1965, as indicated by Table I.

Table I

GROWTH OF ONE-BANK HOLDING COMPANIES 1955-1970

Year	Number of One-Bank Holding Companies	Commercial Bank Deposits (Billions)	Percent of Total U.S. Deposits
1955	117	$ 11.6	6.0
1965	550	15.1	4.5
1968	783*	108.2*	24.9
1970	1100**	140.0**	33.8

* Actual and Proposed One-Bank Holding Companies.
** Estimated by Board of Governors.

But even these figures do not fully indicate the sharp, sudden surge of growth in 1968. Within the first eight months of 1968, over 30 of the nation's 100 largest commercial banks announced plans to transform themselves into subsidiaries of one-bank holding companies. By the end of that year unregulated companies, including companies in process of formation, accounted for more than double the volume of bank deposits of regulated companies—$108 billion compared to $49 billion. And by the close of 1970, at least 1,100 commercial banks with total deposits of about $140 billion were believed to be affiliated with one-bank holding companies, compared with 119 regulated groups with 890 banks and deposits of approximately $70 billion. Together, the two classes of holding companies accounted for almost half of all commercial bank deposits in the United States, with unregulated companies accounting for two thirds of the total. This remarkable change in banking structure occurred in less than three years.

Reasons for One-Bank Holding Company Growth Increasing costs were an important factor motivating banks to adopt the one-bank holding company form of organization. Commercial banks must necessarily rely on the deposits of the public for their principal source of funds to use in acquiring earning assets. To the extent that demand deposits are available, operating costs are lower than is the case if interest must be paid to attract time deposits. Similarly, the lower the interest rate banks pay for time deposits, the lower the costs of such funds.

Between 1947 and 1967, changes in the ratio of demand and time deposits and in the maximum rate structure for time deposits combined to increase substantially the cost of bank funds. The shift from demand to time deposits is shown in the following table:

Table II

GROWTH OF DEMAND AND TIME DEPOSITS IN COMMERCIAL BANKS, 1947-1967
(in billions)

	Demand	Time	Total	Percent Demand of All Deposits
1947	108	34	144	75
1967	211	244	455	46

Source: **Federal Reserve Bulletin.**

Over the 20-year period, while total deposits were more than tripling, the share represented by demand deposits fell from 75 percent to 46 percent. In the same period, the pressure of competition for funds among banks and other financial intermediaries, especially savings and loan associations, forced interest rates on time deposits ever higher.

In 1968 and 1969, as interest rates continued to escalate, commercial banks found themselves at an increasing disadvantage in the competition for funds due to the ceilings imposed by Regulation Q. A bank holding company could avoid restrictions, however, by issuing commercial paper, just as any other corporate borrower. The funds so acquired could then be made available to a bank affilate for use in its banking business, and more and more banks began to resort to this method of acquiring funds.

A second factor stimulating the creation of one-bank holding companies was the growing investment by banks in expensive data processing equipment and personnel. This development in the 1960's generally paralleled the change in deposit composition and the higher cost of funds. More important, however, the rapid evolution in data processing technology and automation, and their interconnection with communications networks, opened up new opportunities for the larger commercial banks in particular to serve business and consumer accounts by handling their varied record-keeping and other needs in more effective ways. Typically, these banks possessed substantial excess machine capacity. New uses of equipment held the promise of both lowering unit costs and expanding the range of services available to bank customers.

A prominent banker and early advocate of the one-bank holding company movement summed up the cumulative effect of these changes in 1969:

> Several events have been working to wrench banking about in the last decades. Probably the most fundamental has been the shift in the deposit mix that has made banks more dependent on time deposits and other high-cost funds.
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> But perhaps the most pressing event has been the surge of competition, particularly since 1963. Banking law and regulations have always paid service to the idea that there should be substantial competition among financial institutions and within the banking industry. Yet the weight of legislation enacted during the 1930's and long prevailing was toward restraint—the protection of solvency and the containing of harmful competitive practices that might again lead to widespread bank failures.
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> At the same time, new consumer demands have surfaced. Individuals and businesses, to say nothing of local governments and tax-exempt institutions, have sought from banks new and more sophisticated services—such things as account reconciliation, automatic payments or, more incidentally, travel service and credit insurance. Meanwhile, strides in bank technology—notably computerization—have opened the way to substantial efficiencies through the expansion of services, geographically as well as in kind.
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> * * *
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> These events, blurring the lines that once compartmentalized credit markets and creating various new cost pressures, have put banks under heavy onus to diversify, to find new areas where their resources and experience could be profitably put to work. And many have moved into fields which even if not unrelated to banking have not traditionally been part of it—such things as factoring insurance, equipment-leasing, mortgage-servicing, data processing, travel services, and credit cards.[7]

National banks led the movement into new market areas in the 1960's, with support from the Office of the Comptroller of the Currency. Under the aggressive leadership of James J. Saxon and his successor, William B. Camp, the Comptroller's office issued a number of interpretations opening the way for national banks to enter these new areas.

Nevertheless, banks faced formidable legal obstacles in attempting entry into new markets. State-chartered banks operating under more restrictive laws and regulations, and many existing nonbank companies already furnishing these services, did not welcome the innovations. A number of bank and nonbank competitors throughout the country retaliated with litigation challenging the power of national banks under existing law and their charters to compete in the new ways. The Supreme Court upheld the right of competitors furnishing data processing and travel agency services to challenge national bank entry into their market areas.[8] While the Court's decisions did not reach the merits of the question whether national banks may in fact, under their charters and existing Federal law, engage in new activities not traditionally regarded as "the business of banking," they cleared the way for such tests. Thus, a long shadow of doubt spread over the legal status of banks entering new market areas, and this at the same time that Federal antitrust enforcement was increasingly thwarting bank growth by acquisitions of other banks. An editorial in *The American Banker* gave the following appraisal of these decisions:

> It was stunning for bankers who had believed themselves to be well sheltered when the Supreme Court affirmed lower court decisions granting competitors standing to sue national banks. That standing had not been granted before, and to make sure it was not, the American Bankers Association for the first time had entered a court case of this type as amicus curiae on behalf of a sued bank, to support the contention that competitors lacked standing; but even so, the courts found that they have a right to sue, and now it is a whole new legal ball game.
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> * * *
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> It is possible, of course, that the banks will win the trials, and be adjudged as acting within their rights by these extensions of competition; but the point now established is that they do have to undergo this adversary process, and are no longer free to expand unencumbered by such challenges. And no matter what the results in specific cases, the establishment of this new principle is bound to embolden those who find banks tough competitors to seek legal relief.[9]

Organization of a holding company is one, and perhaps the only, method owners of banks may use to insulate themselves against litigation attacking their right to enter new areas not specifically authorized by statute. Holding companies are usually corporations organized under the general business laws of a state and can, therefore, lawfully engage in a wide variety of business activities. If a holding company is in fact competing in a number of market areas other than banking, there is less risk that courts will "pierce the corporate veil" and impute to the holding company the same legal restrictions applicable to a bank owned by such a company.[10]

A number of powerful economic and legal considerations thus converged in 1968 to cause large and small banks alike to transform themselves into

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[7] C. C. Cameron, "A Breakthrough in Banking," *The One-Bank Holding Company* (1969), pp. 57-59.

[8] *Association of Data Processing Service Organizations, Inc.* v. *Camp*, 397 *U. S.* 150 (1969); *Arnold Tours, Inc.* v. *Camp*, 400 *U. S.* 45 (1970).

[9] *The American Banker*, March 3, 1970.

[10] A real risk nevertheless exists. This was clearly established early in March, 1971, when the Supreme Court refused to review a lower court ruling which held that operation of an armored car deposit pick-up service violated the branch banking law of the State of Georgia, even though the service was operated by a subsidiary of a bank holding company. *The American Banker*, March 2, 1971. Yet to be determined is the possible effect of the 1970 amendments on rulings based on the law in effect prior to December 31, 1970.

subsidiaries of one-bank holding companies. The mood was aggressively expansionistic, as reflected in these words from *Fortune:*

> In 1967, Harry Volk had only ten years in banking, yet that had been enough to know that the future of the banking business lay with the "finance industry." Accordingly, he turned his Union Bank of Los Angeles into a *de novo* commercial corporation called Union Bancorp., which became the owners of the bank.
>
> After a year or so of hesitating—and duly noticing Union Bancorp.'s impressive earnings—other banks soon followed, first stepping, then pushing, finally stampeding into line. The accelerating rush was more than an example of "an idea whose time had come." Bankers sensed that Congress might impose new restrictions but might also provide some sort of "grandfather protection" for those who got there first.[11]

Congressional Debate and Differences, 1969-1970

Large banks were not the only leaders in the rush to form one-bank holding companies. Conglomerate enterprises such as Signal Oil & Gas, Gulf & Western Industries, and Sperry and Hutchinson also began acquiring commercial banks of substantial size to complement their operations. The dread of abuses, including raids on bank resources for the benefit of nonbank affiliates, favoritism by the holding company bank in lending to customers of its nonbank sister organizations, and even the growth of giant banking-industry combinations in the pattern of the *zaibatsu* which dominate the Japanese economy, generated irresistible pressures to amend the Bank Holding Company Act to insure that these potential evils would not occur.

No less than five different bills to control one-bank holding companies were introduced in the House and Senate in 1969. All agreed upon coverage of one-bank holding companies, but they differed widely in their approach to other major issues. These were primarily the identity of the agency to administer the new legislation, the date of a "grandfather clause" or other exemptive provisions, and the all-important question of the permissible nonbanking activities for bank holding companies.[12] These differences generated two full years of debate, the equal of the memorable 1966 battle to bring bank mergers and bank acquisitions by regulated holding companies under antitrust control. A typical headline early in this debate announced "Administration, Congress Near Blowup Over Controlling One-Bank Holding Firms."[13]

First blood was drawn by advocates of a highly restrictive bill. Late in November 1969, the House passed a measure with a "laundry list" of business activities specifically designated as "not in the public interest to be carried on by bank holding companies of subsidiaries thereof." It included insurance, data processing, accounting, travel agency, securities and leasing services. The proposed bill limited other business activities of bank holding companies to those "financial or fiduciary in nature . . . so closely related to the business of banking as to be a proper incident thereto."

The House-passed bill (H.R. 6778) would thus have specifically foreclosed bank holding companies from insurance activities even though the original 1956 Act had authorized them under certain conditions, and might well have blocked any future expansion of approved financial or fiduciary activities. Two tests had been developed by the Board in 15 years of acting upon proposed applications to perform "financial, fiduciary or insurance" activities authorized under the original 1956 Act: (1) whether such activities were "so functionally integrated with or required for banking operations as to make them in effect part of the parcel of such operations";[14] and (2) whether their performance by commercial banks was in accordance with common regional practice among banks in the areas concerned.[15] In practice, these tests had proved so rigorous that only a handful of applications were filed during the entire 15 years that the 1956 provisions were in effect, and most of the approvals were for insurance agencies which would have been banned under the House legislation. The restrictive nature of the House bill was underscored by its designation of May 9, 1956, the date the original Act became effective, as the "grandfather" date establishing retroactive coverage of the law.

With passage of H.R. 6778, proponents of more liberal legislation concentrated their efforts in the Senate. The Senate approved a bill *without* the "laundry list" of prohibited activities, and its bill also contained a provision designed to give the Board greater discretion in approving bank holding company applications to engage in nonbanking activities. Specifically, it stated that such activities should be

> . . . functionally related to banking in such a way that their performance by an affiliate of a bank holding company can reasonably be expected to produce benefits to the public, such as greater

[11] Sanford Rose, "The Case for the One-Bank Holding Company," *Fortune,* May 15, 1969, p. 310.

[12] H. R. 6778, sponsored by Rep. Wright Patman; H. R. 9385, introduced by Rep. Widnall on behalf of the Administration; S. 1052, sponsored by Sen. Proxmire; S. 1211, sponsored by Sen. Sparkman; S. 1644, the Senate counterpart of H. R. 9385 of the Administration introduced by Sen. Sparkman; and S. 2382, sponsored by Sen. Brooke.

[13] *The Wall Street Journal,* February 13, 1969.

[14] "Application of Transamerica Corporation Relating to Occidental Life Insurance Company of California," *Federal Reserve Bulletin,* September, 1957, pp. 1017-1018, 1029-1930.

[15] See, e. g., "First Bank Stock Corporation," *Federal Reserve Bulletin.* August, 1959, pp. 917-954.

convenience, increased competition or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased competition, conflicts of interest or unsound banking practices.[16]

The Senate bill would also have allowed one-bank holding companies to continue to engage in nonbanking activities in which they were engaged on March 24, 1969, regardless of whether they met the foregoing test.

One major new feature appeared in the Senate version of H.R. 6778. This was a provision that in some respects imposed more stringent antitrust restrictions upon commercial banks in their basic operations than those applicable to business and industry generally under the Sherman and Clayton Acts. The new provision, subsequently enacted into law, subjects *all* commercial banks, regardless of whether they are in a holding company group, to the following absolute stricture:

A bank shall not in any manner extend credit, lease or sell property of any kind, or furnish any service, or fix or vary the consideration for any of the foregoing, on the condition, agreement or understanding
(1) that the customer shall obtain some other credit, property or service from such bank, a bank holding company of such bank, or from any subsidiary of such bank holding company;
(2) that the customer provide some other credit, property, or service to such bank, the bank holding company of such bank, or to any subsidiary of such bank holding company; or
(3) that the customer shall not obtain some other credit, property, or service from a competitor of such bank, bank holding company of such bank, or any subsidiary of such bank holding company.[17]

Two classes of exceptions were written into this absolute prohibition against tie-ins. One provides that banks may continue to require loan customers to maintain compensation balances as compensation for loans, and ask correspondent banks to maintain balances as compensation for services. The second authorizes the Board by regulation or order to permit such exceptions as it considers will not be contrary to the purposes of the prohibition.[18]

But even these exceptions do not apply in the event of antitrust charges under Section 3 of the Clayton Act and under the Sherman Act. As pointed out by the Department of Justice in a letter to the Chairman of the House Committee on Banking and Currency, "It is important to remember that any tie-ins in the area of traditional banking practice will remain fully subject to normal sanctions under the antitrust laws."[19]

[16] H. R. 6778, as amended and adopted by the Senate, S. Rep. No. 91-1084, 91st Cong., 2d Sess. (1970), Section 4 (c)(8).

[17] 84 Stat. 1766-1767 (1970).

[18] 84 Stat. 1767 (1970).

[19] *Washington Financial Reports*, No. 47, November 23, 1970, p. T.6; Compare *Fortner Enterprises, Inc.* v. *United States Steel Corp.*, 394 *U. S.* 495 (1969).

The 1970 Amendments A compromise between the House and Senate bills was reached in the course of a marathon three week conference in December, 1970, described by one newspaper as "one of the most contentious sessions ever held on banking legislation."[20] Negotiating teams representing the two legislative bodies were headed by Senator Sparkman, Chairman of the Senate Banking and Currency Committee, and Representative Patman, Chairman of the corresponding House Committee. There was dissension within each team, and sharp disagreement later as to the meaning of the compromise measure agreed to.

Debate centered around the new provisions authorizing bank holding companies to engage in nonbanking activities. There is little doubt about the meaning of most of the other 1970 amendments. The amended statute covers one-bank holding companies on the same basis as multi-bank companies and now includes partnerships as well as corporations, trusts, associations and similar organizations. Sole administrative jurisdiction is vested in the Board, which is authorized to determine that such an organization exercises controlling influence over a bank or bank holding company even if it does not own or control 25 percent or more of the shares, or the election of a majority of the board of directors, of a bank.

All companies subject to the 1970 amendments are required to register with the Board on forms to be prescribed prior to June 30, 1971. A "grandfather clause" date of June 30, 1968, is established, which permits companies to continue activities engaged in continuously since then, regardless of whether they are authorized under the new amendments.[21] However, this is subject to the following qualification: The Board may at any time, after opportunity for hearing, terminate the authority conferred on any company by the "grandfather clause" if it determines that such action is necessary to prevent undue concentration of resources, decreased or unfair competition, conflicts of interest or unsound banking practices. In addition, the Board must, within two years, review the nonbanking activities of all companies controlling banks with assets of over

[20] *The American Banker*, December 24, 1970.

[21] Three other classes of exemptions are provided: Section 4(c)(11) exempts from the statute any company
more than 85 per centum of the voting stock of which was collectively owned on June 30, 1968, and continuously thereafter, directly or indirectly, by or for members of the same family, or their spouses, who are lineal descendants of common ancestors.
Section 4(c)(12) exempts companies which agree to divest themselves of their banks on or before December 31, 1980; and Section 4(d) grants to the Board discretionary authority to exempt one-bank holding companies existing prior to July 1, 1968, from the divestiture requirements of Section 4 provided certain conditions exist, and subject to such conditions as the Board deems necessary to protect the public interest.

$60 million to determine whether such activities should be terminated.

As to permissible nonbanking activities, the compromise standard finally agreed upon provides that new activities may be approved only if they are determined by the Board to be ". . . so closely related to banking or managing or controlling banks as to as to be a proper incident thereto. . . ." In making determinations, the Board must consider whether the activities

> . . . 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 interests, or unsound banking practices.[22]

The Board is also authorized to differentiate between proposed acquisitions of going concerns by holding companies proposing to enter new areas, and their entry *de novo*.

Recent Actions by the Board Soon after the new law became effective, the Board on January 25, 1971, published for comment a proposal to authorize bank holding companies to engage in ten different nonbanking activities, subject to approval by the Board in individual cases.[23] Unlike acquisitions of banks, no geographic limitations are imposed as to nonbanking activities either by the law or by the Board's proposed authorization. Since the proposed activities—including, particularly, mortgage loan and finance offices—involve some functions similar to those performed by banks, strong opposition to permission to expand across state lines has already been registered, most notably by the Independent Bankers Association.[24] The nature and extent of comments received have caused the Board to schedule hearings in April and May on the proposed activities, with particular attention to be given to permissible insurance agency and brokerage services, and to the furnishing of data processing and bookkeeping services. Only after the testimony at these hearings will the Board's initial regulations be made outlining the scope of permissible activities.

Concluding Comments As discussed in Part I, the desire to supplement Federal and State branch banking legislation to prevent creation of regional or nationwide banking organizations by means of holding companies was a prime factor leading to enactment of bank holding company regulation in 1956. At that time, bank holding companies were restricted to banking and managing or controlling banks, were effectually prevented from further expansion across state lines, and were barred from substantially all types of nonbanking activities.

In 1956, when the Bank Holding Company Act became effective, enforcement of the antitrust laws against commercial banking had been attempted in only one case, and that attempt had failed. By 1970, all types of bank mergers and consolidations, and all bank holding company acquisitions of banks, were subject to prior antitrust review both administratively by the Federal banking agencies and by the Department of Justice and the Federal courts.

During the 1960's major changes occurred in the economic environment of the commercial banking industry. The cumulative effect of these changes caused many leading banks, accounting in the aggregate for a substantial percent of total commercial bank deposits in the United States, to expand or plan to expand into many new service and geographic areas by means of the one-bank holding company. Congress reacted with legislation bringing one-bank holding companies under regulation and conferring upon the Board of Governors' broad discretion to authorize such expansion within the framework of guidelines embodying the substance of the traditional antitrust "rule of reason," tailored to the particular conditions of the commercial banking industry. Strict new provisions limiting the use of tying devices were made applicable to all commercial banks. For the future, enhancement of competition and the preservation of the traditional separation of banking and commerce will very likely be the principal guideposts for regulating expansion of commercial banking in the United States.[25]

William F. Upshaw

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[22] Bank Holding Company Act, Section 4(c)(8) as amended by the Bank Holding Company Act Amendments of 1970.

[23] These were: (1) operating as a mortgage, finance or factoring company; (2) operating as an industrial bank; (3) servicing loans; (4) acting as fiduciary; (5) acting as investment or financial adviser; (6) leasing personal property subject to specified restrictions; (7) acting as insurance agent or broker, principally in connection with extensions of credit by the holding company or its subsidiaries; (8) acting as insurer for the holding company and its subsidiaries or with respect to insurance sold by the holding company or any of its subsidiaries as agent or broker; (9) providing bookkeeping or data processing services for (a) the holding company and its subsidiaries, (b) other financial institutions, or (c) others, provided that the value of services performed by the company for such persons is not a principal portion of the total value of all such services performed; and (10) making equity investments in community rehabilitation and development corporations engaged in providing housing and employment opportunities for low and moderate income persons.

[24] *Pratt's Letter*, March 5, 1971.

[25] See, e.g., William W. Sherrill, "Some Reflections on the New Bank Holding Company Legislation," *Speech*, Washington, D. C., March 16, 1971.

Economic Review of 1970 . . .

THE FIFTH DISTRICT

Efforts to overcome inflation continued to be a prime economic concern in 1970 as in 1969, and prevailing conditions gave evidence of the deep entrenchment of inflation in the nation's economy. As anti-inflationary policies were pursued, unemployment began a steady climb, and the problem became one of preventing the slowdown from slipping into a deep recession. The Fifth District shared with the nation the problems of rising wages, prices, and unemployment, as well as a contraction in the construction industry.

Economic data on states and regions are seldom available immediately following the end of the year. Even now, some of the final statistical series necessary for a complete evaluation of economic conditions within the District are not available. Thus, in addition to the published statistical sources, this article depends heavily upon responses to the Fifth District Opinion Survey of Business Conditions conducted by the Federal Reserve Bank of Richmond.

Questionnaires are mailed at four-week intervals, so that replies are received and compiled during the week preceding each meeting of the Federal Open Market Committee. The survey sample currently contains between 80 and 90 respondents representing manufacturing, banking, and trade and services throughout the Fifth District. The sample is stratified so as to represent all important industries and all regions of the District. In order to obtain more accurate data and thus a better picture of general economic conditions, the survey questionnaire was revised in May 1970. Accordingly, the charts and comments that follow pertain to the period from May 1970 through February 1971.

The graphs show diffusion indexes computed from responses to the questionnaires. These indexes are interpreted as follows: a +1 indicates that all respondents feel that conditions in that particular category are "up," a —1 shows that all replies are "down," and 0 indicates that "up" and "down" responses are evenly distributed. Thus, movements in the index may reflect convergence of opinion about the direction of change without indicating a change in the economic series itself.

Manufacturing Weakness in sales accompanied by large wage settlements produced a serious profit squeeze in manufacturing industries throughout the nation last year. District survey respondents also reported weakness in shipments, volume of new orders, and backlogs of orders in both durable and nondurable goods manufacturing. This sluggishness characterized some of the District's most important industries, including textiles, chemicals, nonferrous metals, and furniture. Inventory levels, which remained fairly stable on the high side, were a continuing concern for manufacturers throughout the year, as most respondents felt that inventories were too high relative to desired levels.

Retail Sales Retail sales fell off during 1970 in the nation at large, with durable goods purchases, particularly appliances and furniture, suffering more than nondurable goods. The situation was aggravated in the final quarter of the year by the General Motors strike. The ensuing decline in auto sales was the largest quarterly drop in 20 years. The level of consumer purchases during the Christmas season was greater than expected, lending support to the belief that the downward trend in retail sales was reversing. The first two months of 1971 have tended to confirm that conclusion.

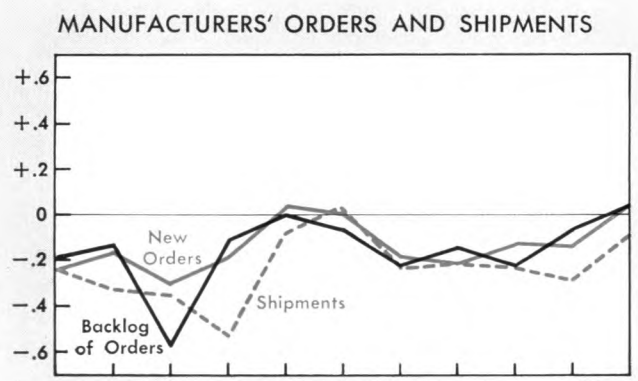
The situation in the Fifth District, as indicated by the survey, was much the same. Retail sales, excluding autos, were consistently down until fall, when an upturn became evident, partly in accord with seasonal expectations. Auto sales were poor early in the year, and, as the work stoppage stretched from September into November and output was significantly reduced, sales dropped sharply. District surveys show that this trend is continuing into 1971.

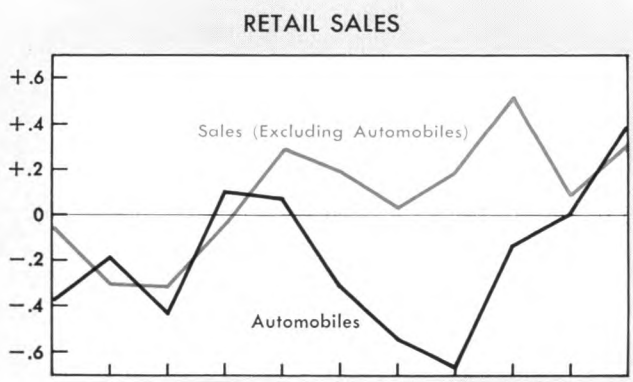
Employment and Unemployment Patterns of employment and unemployment within the District generally paralleled those of the nation throughout 1970. The District's total civilian employment grew from 8,216,100 in December 1969 to 8,245,400 in December 1970, an increase of .4 percent. Over the same period unemployment in the District increased by 30 percent from 240,600 to 313,100, but this 3.7 percent rate of unemployment for December 1970 was considerably below the 6.0 percent seasonally adjusted national rate.

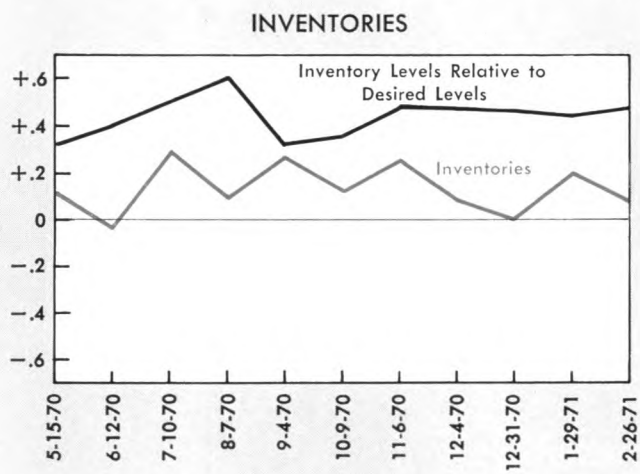
Survey respondents in the District interpreted the employment situation as becoming progressively weaker during most of 1970, as the number of respondents reporting declines in employment outnumbered those reporting increases throughout the year. At the same time, however, numerous respondents indicated that while the supply of available labor was usually adequate, it was often difficult to find labor of the desired quality, particularly skilled labor. The District's employment situation has yet to show clear signs of strength in 1971, according to the survey.

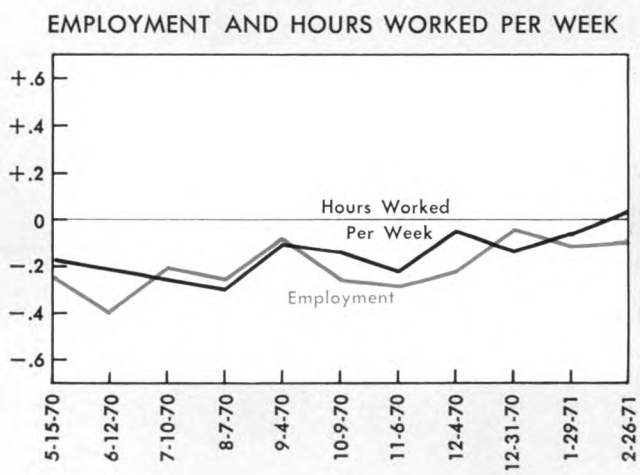
Wages and Prices The survey accurately reflected wage and price movements in the Fifth District, indicating that despite scattered reports of price declines and price shading, the price trend was up until late in the year. In the last two months of 1970, and thus far in 1971, surveys have indicated that among manufacturers, price decreases outweighed increases, particularly in the textile and nonferrous metals industries. Price advances were generally the rule among businesses in the trade and services category. Upward pressure on wages was consistently reported by survey respondents during 1970, and this pressure is continuing in the current year. Both 1970 and 1971 are record years in terms of numbers of employees affected by collective bargaining agreements in the nation at large, and the effect of the settlements is clearly felt in the District. Numerous work stoppages occurred in the District last year, and survey respondents continue to express concern about the likelihood of further work stoppages in the District this year.

Construction For the U. S. at large, 1970 was a year of marked recession in residential construc-









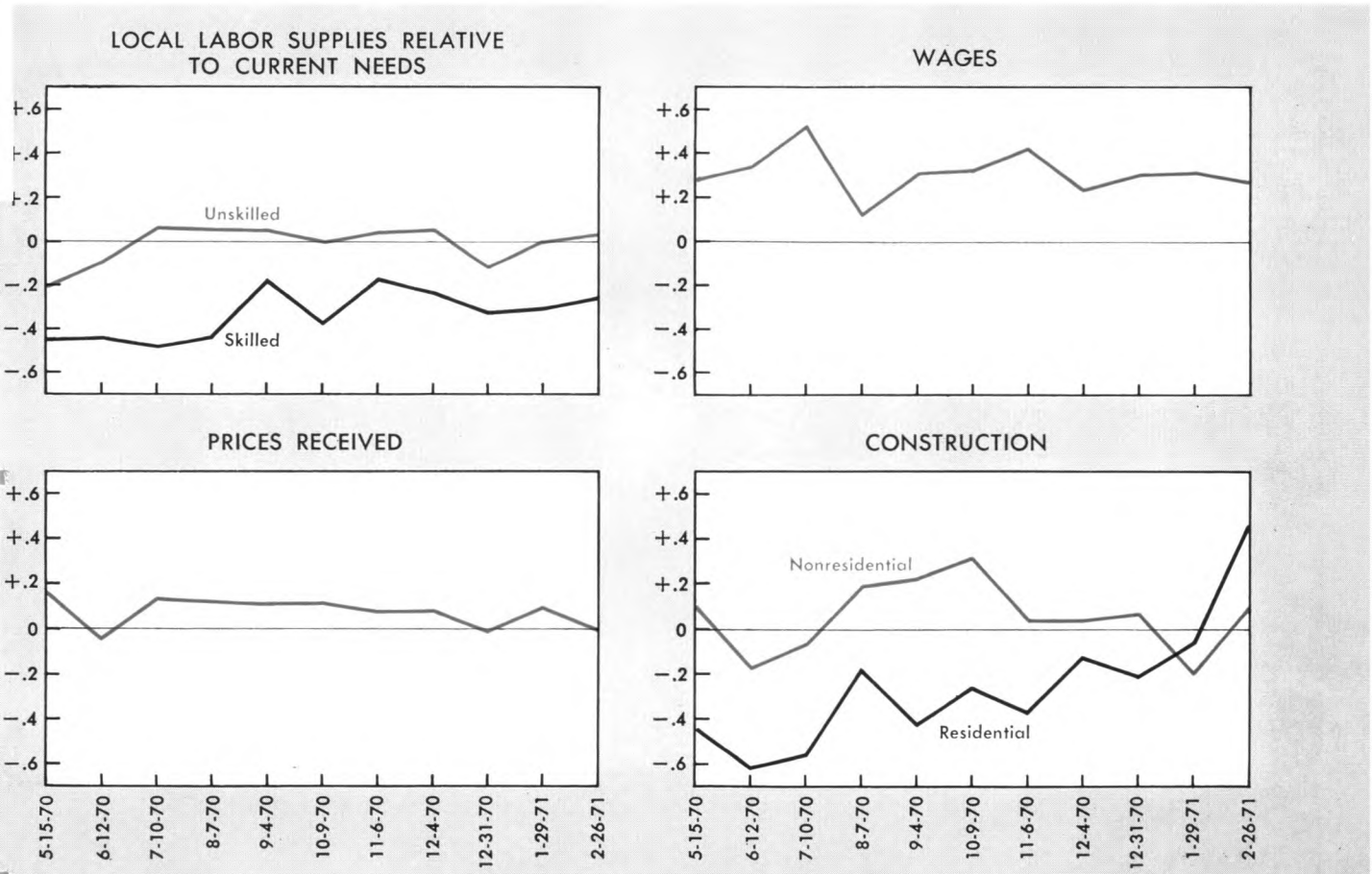
tion, continuing the trend that prevailed throughout the previous year and reflecting the effects of rising costs of materials and labor as well as the scarcity of funds.

Survey respondents reported a similar weakness in residential construction in the District, and for the District as a whole, residential construction declined from the 1969 level. North and South Carolina were exceptions to this general trend; both states recorded increases in square feet, number of dwellings units, and value of total residential building in 1970. In December, bankers throughout the District began to anticipate increased activity in residential construction in the months ahead, and early 1971 surveys show an apparent recovery underway in this field.

During most of 1970, most respondents reported that nonresidential construction activity was gradually increasing. Actual statistics show, however, that the District experienced a slight decline in the number of projects, square feet, and value of total nonresidential building, except in the District of Columbia area where there was a substantial increase in both the square feet and valuation of nonresidential construction. The lifting of the freeze on Federal construction projects was perhaps a significant factor in this growth.

Loan Demand Increases in both mortgage and business loans at District banks were reported until July, when a downward trend developed and lasted throughout the remainder of the year. At year end, business and mortgage loan demands in the District were particularly weak. This condition also existed in the nation at large, and coincided with a substantial growth of the liquidity positions of banks. Consequently, several cuts in the prime rate occurred, market interest rates declined significantly, and banks actively sought borrowers. A slight turnaround in the demand for business loans has occurred, according to respondents, during the first two months of 1971, but so far, it does not represent a significant increase. Mortgage loan demand, on the other hand, has made a much more dramatic recovery since the beginning of the year.

Demand for consumer loans, while marked by

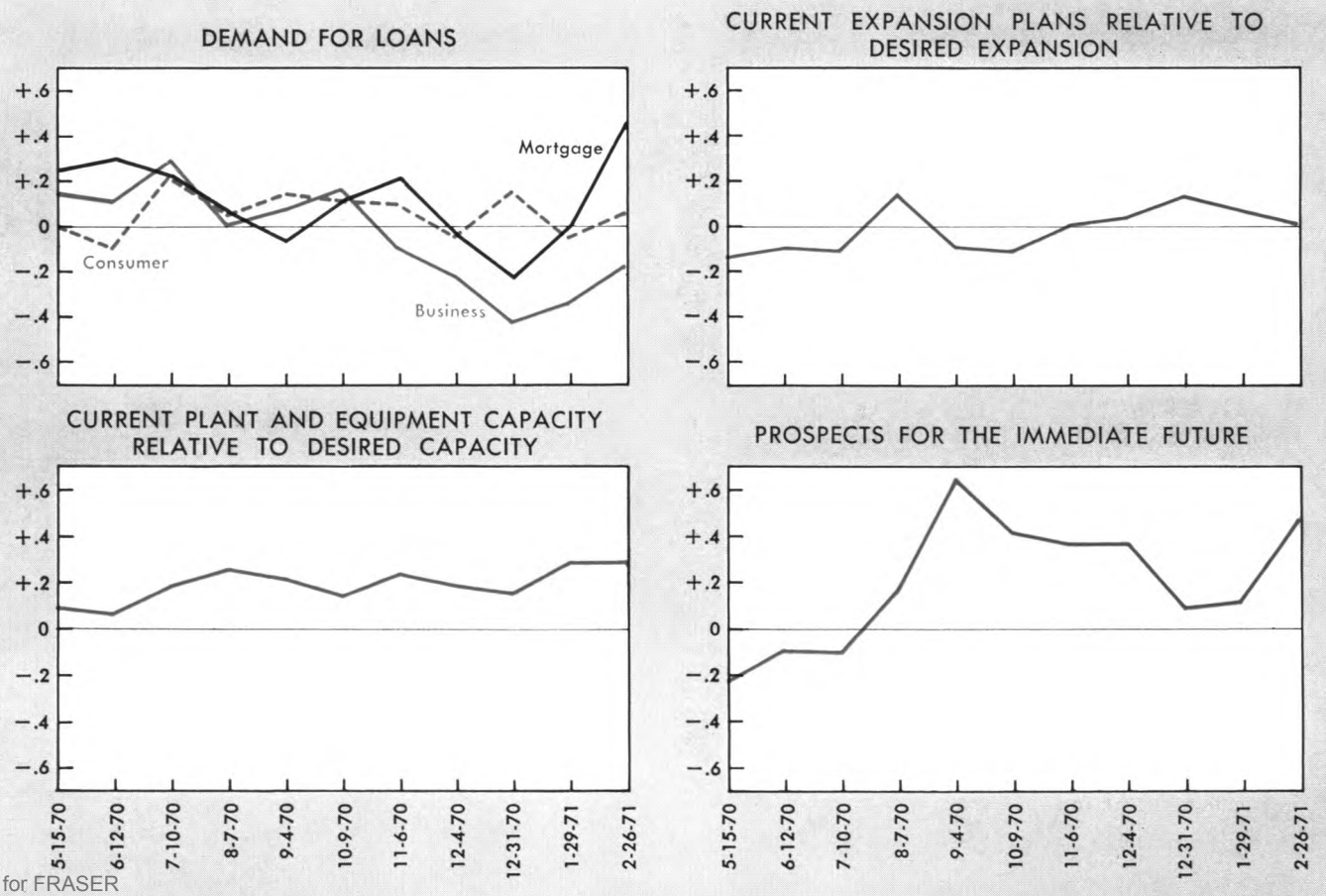


fluctuation, increased moderately on balance during 1970, according to District bankers. Since 1971 began, consumer loan demand has strengthened further in the District.

Capital Spending During the first three quarters of the year, District manufacturing respondents consistently reported excess plant and equipment capacity, while businessmen in trade and services generally considered their facilities inadequate. Neither group of respondents indicated any strong tendency toward reduction of expansion plans in the early part of the year when the prevailing sentiment among businessmen was that inflationary conditions would continue. In the final quarter, manufacturers began to report cutbacks in capital spending plans, and at year end, this tendency was still in evidence.

While recently announced accelerated depreciation allowances are expected to exert some influence on capital spending throughout the nation in 1971, reports from District manufacturers fail to indicate any tendency to step up capital expenditure plans. The survey results imply that capital spending by District manufacturers is not readily affected by changing economic policies.

Prospects for the Immediate Future From May through the summer months of 1970, the general attitude expressed by respondents concerning economic conditions in the Fifth District was one of uncertainty, produced not only by economic developments but by the discontent and social unrest felt throughout the nation. Remarks to the effect that the economic situation was likely to worsen before any improvement occurred were not uncommon. By September a definitely optimistic tone was apparent as respondents anticipated an increase in economic activity. By the end of the year, a significant majority still expected an economic upturn, although cautioning that such a change would be slow in coming and expressing some discouragement over the obvious sluggishness of the economy. Moreover, manufacturers were less optimistic than respondents in trade and services, citing the persisting problems of excess inventories and plant and equipment capacity, rising costs, employment weakness, and the effects of strikes. *Ann M. Spivey*



Uncertainties Cloud the . . .

AGRICULTURAL OUTLOOK FOR 1971

Top level economists of the U. S. Department of Agriculture presented their views of this year's prospects for the nation's agriculture at the National Agricultural Outlook Conference late in February. A capsule review of their forecasts follows.

The nation's farmers can probably look forward to some strengthening in farm prices and incomes as the year 1971 progresses. Realized gross farm income may well achieve a new record. But farm production expenses will likely rise more than enough to offset the increase in gross income. Realized net farm income will thus probably fall slightly below that in 1970, even though the income situation will likely brighten later in the year.

This appraisal of the agricultural outlook assumes that 1971 will be a year of stepped-up activity for the general economy. Both fiscal and monetary policies are expected to favor economic growth. Consumers' disposable personal incomes, boosted by increased Federal income tax exemptions and higher wage rates, are likely to rise further. Such income gains, although probably not as large as in 1970, are expected to support a strong domestic demand for farm products. In addition, foreign demand continues exceptionally strong, with the value of total farm exports in the current fiscal year expected to hit an all-time high.

There are more uncertainties than usual in this year's outlook, however, especially for crop farmers. They are faced with making adjustments to the new farm program, to the possibility of another outbreak of Southern corn leaf blight, and to a limited supply of blight-resistant seed corn. The outlook for livestock farmers is also cloudy, with prospects hinging on feed costs and on producers' breeding decisions during the first half of the year.

Expenses and Income Farm production expenses are expected to advance to another record high. The gain, however, seems likely to be less than in 1970. The biggest increase is expected to be for purchased feed. Overhead costs are headed higher. Sizable increases are also anticipated for wage rates, farm machinery, insurance, and fertilizer. Moderating factors in the farm cost picture are the expected softening in interest rates and lower prices for feeder livestock.

This year's outlook for cash receipts from farm marketings points to a slight gain over last year. The increase, if realized, would probably reflect a greater volume of marketings, with little change from 1970 in average prices received by farmers. Crop receipts may register a sharp increase, while livestock receipts will probably hold near last year's level. Some decline in Government payments to farmers is indicated and will offset part of the expected gain in cash receipts. Even so, gross farm income is expected to top last year's record, although heavier outlays for farm production expenses will more than offset the income gain. Hence, total realized net farm income is expected to fall short of the 1970 figure. But with a declining number of farms, net income realized per farm may show only a slight drop from last year's near-record level. A sizable gain in farmers' income from nonfarm sources appears likely and will help compensate for the expected dip in net income from farming.

Commodity Prospects Highlights in the outlook for major Fifth District commodities as seen by the Department of Agriculture follow:

Poultry and Eggs: Poultry farmers are still faced with low prices and high feed costs. Lower broiler, turkey, and egg prices are likely to prevail through mid-1971. Broiler and egg prices may strengthen later and average slightly higher in the second half, but lower turkey prices may continue. Large pork supplies will tend to keep poultry prices under pressure through midyear. Substantially higher feed prices are in prospect for most of the year. Broiler output is expected to average about the same as in 1970, but production of eggs and turkeys may be somewhat larger.

Dairy Products: Prospects are good for another rise in milk production this year. Record-high milk

prices, an easier labor situation, and a good supply of herd replacements point to a slight expansion in output despite rising dairy ration costs. Milk cow numbers will likely continue to decline at a slow rate. Farm prices for milk are expected to show a modest increase, and gross income from dairying will probably rise further.

Meat Animals: Large pork supplies and low hog prices are expected through the first half of 1971. But prices, although down sharply from a year ago, have picked up in recent weeks. A cutback in farrowings will probably occur during the spring months, reducing pressure on prices in the second half.

Fed cattle marketings may hold near year-earlier levels through mid-1971 and then show a moderate increase in the second half. With consumer demand for meat expected to remain strong, fed cattle prices are likely to continue firm.

Tobacco: The outlook for tobacco is mixed. Domestic demand for cigarettes and other tobacco products remains at a high level, but the decline in tobacco use continues. Competition in world markets is growing, and United States tobacco exports in 1971 will do well to hold at the reduced 1970 level. Carry-over stocks will probably change little, despite smaller beginning supplies. Smaller marketing quotas are in effect this year, so growers can be expected to harvest considerably less tobacco than in 1970. On the other hand, price supports are up 4.2% and the smaller crop may well result in higher prices.

Soybeans and Peanuts: The supply-demand situations for soybeans and peanuts offer a study in contrasts—too many peanuts and not enough soybeans. Peanut supplies are at record levels, about 16% above a year earlier. Output this season was one-third above edible requirements and farm use. Soybean supplies, however, are tight and 6% below a year ago. Usage of soybeans is exceeding production by a wide margin for the second consecutive year and will result in another sharp drop in carry-over stocks. Price support for 1971-crop peanuts has been set at $267 per ton, up 4.7% from last year; for soybeans the support level continues at $2.25 per bushel.

Cotton: Prospects for larger disappearance and a slightly smaller supply highlight the cotton outlook. The increase in disappearance reflects better export prospects resulting from dwindling supplies and expanding use of cotton abroad. Combined domestic mill use and exports may exceed 1970 production by over 1 million bales, cutting the cotton carry-over this summer to around 4½ million bales, smallest since 1952. Cotton prices have generally been stronger this season, with the shorter staples doing best. The 1971 loan rate for Middling 1-inch cotton at average location is 19.50 cents per pound, down about 2 cents from 1970.

Farm Credit Outlook Farmers are expected to use more credit this year than in each of the past several years. Keys to this outlook are the easing of the tight money situation and prospects for lower interest rates and higher production costs.

Funds for farm loans should be more readily available both to lenders and to farm borrowers. Life insurance companies, almost out of the farm-mortgage lending business in 1970, may be considerably more active this year. But with lenders increasingly quality conscious, the repayment capacity of the farming operation and the management ability of the farmer are likely to figure more importantly in evaluations of loan requests.

Both long- and short-term farm loans will probably carry lower interest rates. The decline in interest rates in the money markets late last year and early this year has already resulted in some lowering of farm-mortgage interest rates by life insurance companies and the Federal land banks. Production credit associations are also expected to cut their rates because of the sharp drop in the cost of their loan funds obtained from the central money markets through the Federal intermediate credit banks. With the recent increases in bank liquidity, commercial banks can also be expected to make more funds available for farm lending. Many small banks, however, rely primarily on local sources of funds and as a consequence their loan rates are less sensitive to changing money market conditions than are those of PCA's or of large, city banks that regularly tap the central money market. In the recent tight money period, for example, country banks did not raise short-term interest rates as promptly or as sharply as city banks. On the other hand, cuts in their rates may not be as great or as promptly forthcoming as those for city banks.

Farmers will likely remain conservative in making additions to their long-term debt in 1971. Indications are, however, that the use of farm real estate credit will accelerate. Many farmers need to catch up on capital improvements, and if interest rates continue to soften, they may consolidate some of their unwieldy short-term debts into long-term real estate debt. Rising costs of production inputs and a new farm program that encourages larger plantings will increase day-to-day operating expenses and maintain a strong demand for short-term credit.

Some Implications of New Farm Legislation

The Agricultural Act of 1970 contains provisions applicable to the 1971-73 crops of cotton, feed grains, and wheat that are quite different from the programs of past years. Participation is voluntary, and those who choose to participate and receive program benefits have much more freedom to plant and manage their cropland. The flexibility provided by the 1970 legislation makes farmers' response to it highly uncertain.

The new farm program is designed to (1) help farmers shift to a market-oriented agriculture and away from reliance on Government programs; (2) give farmers more options on what and how much to plant; (3) protect and improve farmers' incomes; and (4) keep farm production in line with anticipated demand.

While the 1970 Act continues to protect farm income through payments and loans, it has shifted loan levels of the supported crops to specified minimum levels and away from parity. It thereby eliminates the loan escalating features which have threatened to price United States farm products out of world markets in the past.

A major departure from former farm programs is the elimination of the old system of crop-by-crop allotments whereby a farmer's planting of the affected crops was limited to his acreage allotments or base less diversion. Now allotments and bases no longer dictate the number of acres a farmer is permitted to plant. Instead, they are used only to figure the set-aside acreages and price support payments. Another significant feature of the new legislation is the elimination of the cross compliance requirement. A farmer who operates several farms may now participate in the various programs on one or more farms without doing so on others.

A farmer who has cotton and/or wheat allotments or a feed grain base may become eligible for program benefits by signing up for a specific program or programs during the enrollment period, setting aside the required number of acres, and maintaining his farm's conserving base. Under the set-aside provisions in effect for 1971, a cotton farmer is required to set aside to approved conservation uses an amount of cropland equal to 20% of his farm's base acreage allotment; for the feed grain producer, the set aside amounts to 20% of the farm's feed grain base; and for the wheat farmer, it equals 75% of his domestic allotment.

Once a farmer sets aside the required amount of cropland to approved conservation uses and maintains his conserving base, he is free to plant as much cotton, feed grains, or wheat as he has remaining cropland. Or, he is also free to plant his remaining acres in crops of his choice, except the quota crops —tobacco, peanuts, rice, sugarcane, and extra long staple cotton. This set-aside provision not only gives the farmer freedom to shift acres to crops he can best produce, but it also enables him to employ his land, machinery, and other capital resources more efficiently.

A farmer is required to plant a specified percentage of his farm's acreage allotment or base acreage each year to preserve his allotment or base acreage history. He may plant either the crop for which he has an allotment or base, or an authorized substitute. For 1971, the required planting percentage for cotton is 90% of the farm's base acreage allotment; for feed grains, 45% of the feed grain base; and for wheat, 90% of the domestic allotment. A producer who plants less than the required percentage will have his base or allotment reduced the following year by the amount of the underplanting, up to 20%. If no crop or authorized substitute crop is planted for three consecutive years, the entire allotment or farm base for the affected crop will be removed from the farm. Loss of allotments or base can be avoided, however, if the farmer makes the required set aside and does not collect the price support payment or if he was prevented from planting the required acreage because of some natural disaster. A farmer may plant wheat or feed grains in lieu of cotton for history preservation, but he will not receive cotton price support payments. Cotton cannot be substituted for wheat allotments or feed grain bases, however.

The broader substitution privileges provided by the 1970 Act have special significance this year in view of the very real threat of Southern corn leaf blight and the shortage of blight-resistant seed. Corn producers, for example, may plant wheat and grain sorghum on their feed grain base without loss of history or payments. Farmers in all or parts of nine Southern states, including the entire states of North and South Carolina, have also been declared eligible to apply for permission to substitute soybeans or other crops on corn acreage in 1971 if they can show that they are unable to obtain enough blight-resistant seed to plant at least 45% of their corn acreage base. Similar authority for farmers in several other states is under study.

Sada L. Clarke