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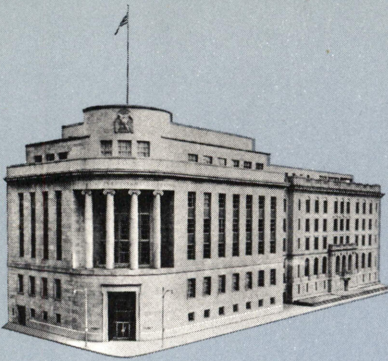

FEDERAL RESERVE BANK OF BOSTON

NEW ENGLAND ECONOMIC REVIEW

Bank Holding Companies and Public Policy

Bank holding companies are playing an increasingly important role in American banking. This article describes their recent growth in the Nation and New England and analyzes aspects of bank holding company organization, operations, and performance that are relevant to public policy.

Increasing Job Opportunities in Boston's Urban Core

New industrial facilities in Roxbury and public transportation to suburban plants create more job opportunities. This article examines the problems of finding new plant sites within the urban core and the impact of the "Employment Express."

SUPPLEMENT:

Pax Americana and the U. S. Balance of Payments

Remarks by Frank E. Morris, President, Federal Reserve Bank of Boston, January 30, 1969.

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Bank Holding Companies and Public Policy

By Steven J. Weiss

Bank holding companies have existed in the United States for over 50 years. Ever since their early days, they have been a subject of continuing controversy among legislators, bankers' organizations, and bank regulatory agencies. A spokesman for independent bankers, testifying before a Congressional committee in 1966, voiced his objections to bank holding companies in strong terms:

> Bank holding companies are the most insidious devices for accelerating the trend to concentration (in banking) and elimination of competition. . . .
>
> Although the laws require autonomous operation of banks by their respective boards of directors, it is common knowledge that holding companies are operated by a single management. The central manager operates the subsidiary banks like puppets on strings held in his hand and can readily shift deposits, arrange loan and bond participations, and in many other ways use the subsidiary banks as a complex to overwhelm the competition of independent banks. . . .

Of course, holding company bankers would respond with equally strong statements in favor of the holding company form of bank organization. Public policy must be based on a balanced view, informed as much as possible by an objective knowledge of bank holding company operations. The above quotation is pertinent insofar as it raises some of the major issues that are relevant for policy purposes. One important question is the extent to which concentration of banking resources is increased through holding companies and the impact that holding company formation and expansion have on banking competition in specific areas. On the positive side, it is important to determine whether and how holding company affiliation yields significant benefits in terms of the convenience and needs of bank customers.

This article will examine bank holding companies, emphasizing aspects that are of particular concern for public policy. First, the present Federal law regarding bank holding companies will be summarized briefly. Growth of bank holding companies in the Nation and in New England in particular will be described, along with an analysis of the principal reasons for growth and the arguments in favor of bank holding company development. Subsequent sections will examine the performance of bank holding companies, their various forms of organization and operation, and the record of regulatory policy to date. The major issues in the current debate about one-bank holding companies will be discussed in the last part of the article.

Definitions. A bank holding company organization is essentially a form of *bank ownership*. Any corporation, business trust, association, or any other similar type of organization which owns or controls one or more banks may be classified as a bank holding company. Subsidiary

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banks (or affiliates) of a bank holding company are independently chartered banks which possess varying degrees of autonomy depending upon the organization and operational policies of the holding company.[1] "One-bank holding companies," *i.e.* organizations that control only a single bank, must be distinguished from *registered bank holding companies* which control two or more banks and are subject to specific regulation by the Board of Governors of the Federal Reserve System. A related form of multi-bank organization, "chain banking," consists of common ownership of more than one bank by an individual, partnership, family or any other group of individuals.

Present Federal Regulation of Bank Holding Companies

Registered bank holding companies are regulated by the Board of Governors under the Bank Holding Company Act of 1956, as amended.[2] The Act's coverage is limited by its definition of a bank holding company in terms of ownership or control of 25 percent or more of the stock of at least two banks. The Act does not apply to one-bank holding companies or to banking chains. It also contains a number of special exemptions, so that not all types of organizations which control more than one bank are required to register. The major purposes of the Bank Holding Company Act were summarized in a Senate Committee Report:

> The Bank Holding Company Act has two chief objectives. First, it seeks to prevent excessive concentration of banks under the control of any holding company. Second, it seeks to prevent holding companies from combining banking and nonbanking businesses. The first objective reflects a desire to guard against undue concentration of control of banking activities because of the importance of the banking system to the national economy. The second objective reflects concern over conflicts of interest that might result in a subsidiary bank extending credit to an affiliated business under circumstances that could endanger the bank or give the borrower an unfair advantage over competitors.

In order to accomplish the first objective, the Act requires prior approval of the Board before any action may be taken which would result in (a) formation of a new bank holding company; (b) acquisitions which give an existing holding company ownership or control of over 5 percent of the voting stock or substantially all the assets of a bank not already a majority-controlled subsidiary; or (c) merger or consolidation of two bank holding companies. The Board, in considering applications for prior approval, is directed to evaluate factors relating to the present and prospective solvency of the institutions involved (the "banking factors"), benefits which might accrue to affected communities ("convenience and needs" factors), and the impact of the proposed transaction on competition in relevant banking market areas (the competitive factor). Amendments enacted in 1966 give particular emphasis to the importance of the competitive factor in the Board's decisions.[3]

Since one-bank holding companies are not covered by the Bank Holding Company Act, the second objective — separation of banking and non-banking businesses — was only partially achieved. Although there are some limited exceptions to this rule, the Act prohibits a registered bank holding company from holding or acquiring stock in companies other than banks

[1]Bank holding companies are usually separately chartered corporations, but a bank which owns stock in one or more other banks (either directly or through a subsidiary) may itself be a bank holding company.

[2]The appendix to this article contains a review of the historical development of Federal bank holding company legislation and a detailed discussion of the 1956 Act.

[3]The Board may receive opinions from other supervisory agencies in connection with applications for holding company acquisitions, and in some cases it may be required to conduct hearings. If the Department of Justice disapproves on antitrust grounds of an acquisition which the Board approves, it has the power to file suit within 30 days to stop the transaction.

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or companies engaged solely in activities closely related to banking.[4]

Other provisions of the Act effectively limit holding company acquisitions across state lines, specify administrative procedures, and outline the Board's regulatory authority.

The Bank Holding Company Act represents the first effective Federal legislation designed to control the growth of bank holding companies and supervise their operations. Enactment of the law followed many years of controversy. Although earlier legislative proposals sought to limit severely the growth of bank holding companies or abolish them altogether, the intent of the present law is essentially precautionary. The present legislation implies Congressional acceptance of the bank holding company as a legitimate form of banking organization.

Growth of Registered Bank Holding Companies

While the Bank Holding Company Act of 1956 was being considered by Congress, there was a flurry of holding company acquisitions, as existing companies apparently feared that the legislation would restrict future expansion. In the 6 months immediately preceding passage of the Act, holding companies acquired 19 subsidiary banks with over $450 million in deposits.

At the end of 1956, 49 separate bank groups were covered by the new legislation;[5] by June 30, 1968, the number had grown to 69. During this period, however, the pattern of growth in the number of registered bank holding companies was quite uneven. The years immediately after enactment brought a *net* decline in the number of registered companies. Twelve companies reduced their stock holdings to less than 25 percent in two or more banks and were therefore no longer subject to Board regulation. Others got rid of their holdings or reorganized in some manner, with the result that 19 companies were no longer on the registered list 2 years after the 1956 Act took effect.[6]

Growth in the number of registered bank holding companies proceeded at a moderate pace for about 10 years, and not until 1966 did the number exceed the original level of 1956. It is possible that uncertainty about the policy that the Board would adopt in ruling on applications to form new holding companies may have dampened the enthusiasm of prospective holding company organizers. In any case, the situation changed dramatically in 1966 and 1967, when there was an upsurge in the number of registered bank holding company formations and expansions. Nineteen organizations were newly added to the Board's list of registered bank holding companies during those years,[7] and the pace of holding company acquisitions increased significantly. All signs point to a continuation of this accelerated trend.

Data on the growth of registered bank holding companies in the United States are presented in Table I, which includes figures on the number of holding company affiliates, banking offices in holding company systems, and the dollar volume of deposits controlled. Average annual percentage increases have been calculated for two subperiods — 1957-65 and 1965-67 — in order to

[4]Provisions were included in the Act to assure that existing bank holding companies could divest their nonbanking interests on an equitable basis.

[5]A larger number of "bank holding companies" were required to register under the terms of the 1956 law, but in some cases a two-tiered organizational structure means that a single banking organization would have to register twice — *e.g.* if one bank holding company controls another bank holding company. The figures given here have been adjusted to eliminate such double counting. They also include two companies which did not register until 1959.

[6]See Gerald C. Fischer, *Bank Holding Companies* (New York: Columbia University Press, 1961), pp. 44-45.

[7]Seven separate groups had existed previously but were required to register for the first time in 1966 as a result of amendments which removed several statutory exemptions that had been written into the 1956 Act.

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Table I

GROWTH OF REGISTERED BANK HOLDING COMPANIES, 1957-1967*, U. S. AND NEW ENGLAND

	No. of Banks Affiliated With Holding Companies	*Offices of Affiliated Banks*	*Deposits of Holding Company Banks ($ Mill.)*
UNITED STATES			
1957	417	1,268	$15,139
1965	468	1,954	27,560
1967	603	2,688	49,827
Avg. Annual % Increase			
1957-1965	1.4%	5.6%	7.8%
1965-1967	13.7	17.4	35.2
1957-1967	3.9	7.9	13.3
MAINE			
1957	3	11	$ 29
1965	4	12	40
1967	6	48	199
Avg. Annual % Increase			
1957-1965	16.5%	1.4%	4.3%
1965-1967	25.0	150.0	181.2
1957-1967	8.3	31.1	39.7
MASSACHUSETTS			
1957	22	140	$ 1,002
1965	23	194	1,378
1967	24	218	1,946
Avg. Annual % Increase			
1957-1965	0.6%	4.3%	4.9%
1965-1967	2.2	5.4	15.6
1957-1967	0.9	4.6	7.0
NEW HAMPSHIRE			
1957	5	5	$ 34
1965	6	9	91
1967	7	10	121
Avg. Annual % Increase			
1957-1965	2.8%	7.9%	15.8%
1965-1967	8.4	5.6	13.4
1957-1967	3.9	7.5	13.9

*Data are for December of each year.

SOURCE: *Federal Reserve Bulletins.*

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illustrate the break in the trend that occurred around 1966. Growth in deposits and the number of banking offices in holding company systems reflects not only the acquisition of new subsidiary banks but also internal growth of existing subsidiaries (including *de novo* branching) and their external growth (by merger). As of December 31, 1967, 65 separate registered bank holding company organizations controlled 603 banks with 2,085 branches and $49.8 billion total deposits in 34 states and the District of Columbia.

Growth in New England. Registered bank holding companies exist in only three of the six New England States — Maine, Massachusetts, and New Hampshire. Vermont is the only New England state that prohibits bank holding companies by statute. Neither Connecticut nor Rhode Island has any law specifically relating to bank holding companies; both states have large branch banks, but no holding companies.[8]

The accompanying maps show the present geographical configuration of registered bank holding company offices in Maine, Massachusetts, and New Hampshire, and Figure I shows the relative importance (in terms of total commercial banking offices and deposits) of holding company systems in these states and in all states where holding company banks exist. By the end of 1967, the bank holding company share of commercial bank deposits was larger in Maine, Massachusetts, and New Hampshire than the average for all holding company states, but there are many individual states where bank holding companies are more important (by this measure) in the overall banking structure. In Maine and Massachusetts bank holding companies also have an above average share of total commercial banking offices. Together, the two Massachusetts holding companies control an unusually large share of commercial banking offices in the state, but that share has declined since 1957, indicating that the number of independent bank offices has grown faster (through *de novo* branching and organization of new banks) than the number of offices operated by bank holding company affiliates.[9]

The growth of bank holding companies in New England has followed a pattern somewhat different from that of the Nation as a whole, as the state figures in Table I indicate. Except for Maine, where a new holding company was organized in 1966, the state figures in the Table do not reveal the sort of dramatic increase in growth after 1965 which characterizes the national pattern. However, the situation appears to be changing, therefore warranting a review of the different factors underlying past growth and prospects for further holding company development in the three holding company states of the region.

(1) MAINE. The first bank holding company in Maine came into existence in the late 1920's. Between 1957 and 1967 the company held a small and relatively stable share of total commercial bank deposits in the state. It acquired only a single additional subsidiary bank over that period. The importance of holding companies in the banking structure of Maine was dramatically increased in 1967, when the largest commercial bank began operations under a new

[8]Massachusetts, one of the few states that has a detailed bank holding company statute, regulates bank holding companies under a law patterned closely after the Bank Holding Company Act. Any bank holding company formation or expansion is illegal without the prior approval of the state's Board of Bank Incorporation. Maine law places no specific restrictions on bank holding companies. In New Hampshire, state law specifically limits holding company growth in two ways: (1) no bank holding company may have more than 12 affiliates; and (2) no bank holding company may hold, through its affiliates, over 20 percent of the total deposits of all banks in the state.

[9]Note again that the number of offices in holding company systems increases as new subsidiary banks are acquired, or as existing subsidiaries add branches *de novo* or by merger. Declines in the national holding company share may reflect de-registration of previously registered holding companies as well as possible slower growth relative to all commercial banks in any given period.

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Map I — MAINE BANK HOLDING COMPANIES

Bangor

Augusta

Lewiston

Portland

KEY:

★, ● DEPOSITORS CORPORATION, AUGUSTA

★, ● MERRILL BANKSHARES, BANGOR

★, ● EASTERN TRUST FINANCIAL ASSOCIATES, BANGOR

Stars indicate home offices of subsidiary banks; dots indicate branch offices.

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holding company with another affiliate. The large increases shown for Maine in Table I and Figure I provide a quantitative measure of the impact of this new holding company formation, but the implications for future holding company development are much greater than the numbers alone indicate. The new company received permission in 1968 to acquire an additional subsidiary and is taking action to acquire several more banks in the near future.

The aggressive activity and plans of this one company have undoubtedly been an important factor contributing to an upsurge of interest in holding companies on the part of Maine bankers. A third bank holding company was organized in 1968, and plans for two more have been announced. If all these plans become effective in the coming year, five registered bank holding companies would control approximately half of the commercial bank deposits in Maine by the end of 1969.

Maine law permits statewide branching by merger. Therefore, the present Maine holding company systems could legally have taken the form of branch banks rather than holding companies. Two reasons may explain the choice of the holding company route over branch banking. First, holding company development offers greater flexibility with respect to future branching. Banks in Maine may branch *de novo* only in their home office county and contiguous counties. When a holding company acquires a subsidiary, the subsidiary retains its power to expand geographically by *de novo* branching in its local area. On the other hand, if the same bank were merged into a bank in a distant county it would become a branch office and the acquiring bank would not be able to establish additional *de novo* branches in the area. Even if this limitation did not exist, holding company organization might be preferred over extensive branch banking for a second reason, namely an expectation that the banking public would rather deal with an institution that has local directors and officers plus a long-standing local reputation and identification. This consideration is particularly important for a state which is as large as Maine and contains many small towns and rural areas.[10]

(2) Massachusetts. The two large registered bank holding companies in Massachusetts began as trust associations in the late 1920's, affiliated or closely connected with large Boston banks.[11] Both had quite extensive systems in 1956 when the Bank Holding Company Act was passed. Total deposits in each of the companies approximately doubled between 1956 and 1967, slightly surpassing the overall deposit growth rate in the state. Their roughly similar deposit growth records were achieved, however, in rather different ways. Growth of one company (in terms of offices as well as deposits) was entirely internal, while the other acquired five new affiliates during the period and two of its banks merged with banks outside the system. Since both companies have consolidated their organizations to some extent by merging subsidiary banks,[12] the net increase in the number of separate holding company affiliates in the state since 1956 has been minimal. One of the present holding companies has recently announced plans for a new acquisition, and the role of bank holding companies in Massachusetts banking may also increase in the near future as a result of new holding company formations.

As multi-office banking organizations, Massachusetts bank holding companies enjoy a distinct advantage over branch banks in their ability to

[10]It would not be such an important factor in Connecticut or Rhode Island, for example, two states that are much smaller and more integrated, economically, than Maine. These states both have extensive branch banking systems under more liberal branching laws than Maine's.

[11]Baystate Corporation's Boston bank connection was terminated in 1962.

[12]Just like mergers involving any insured bank, mergers of holding company subsidiaries are subject to the Bank Merger Act of 1960, as amended.

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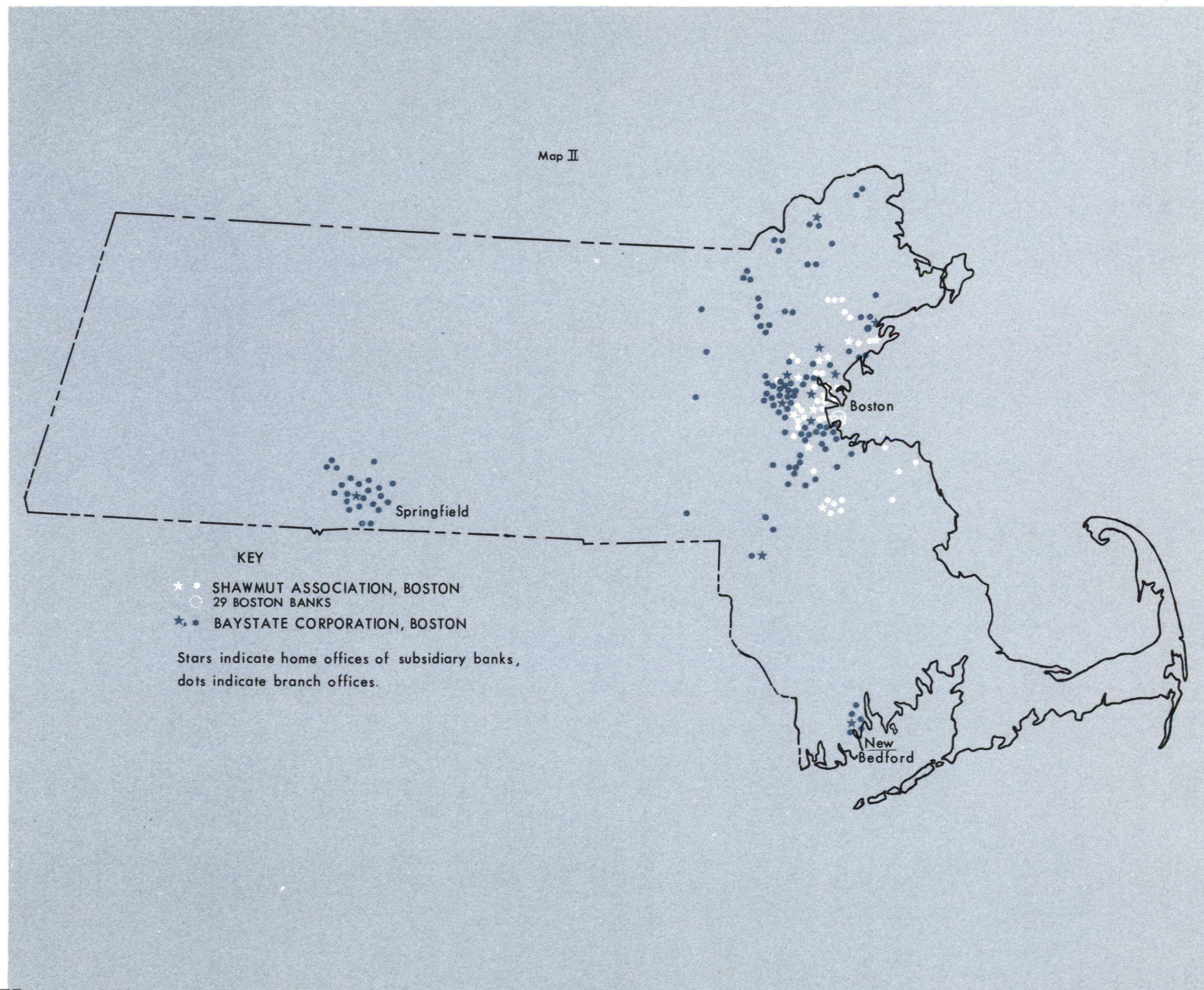
Map II — MASSACHUSETTS BANK HOLDING COMPANIES



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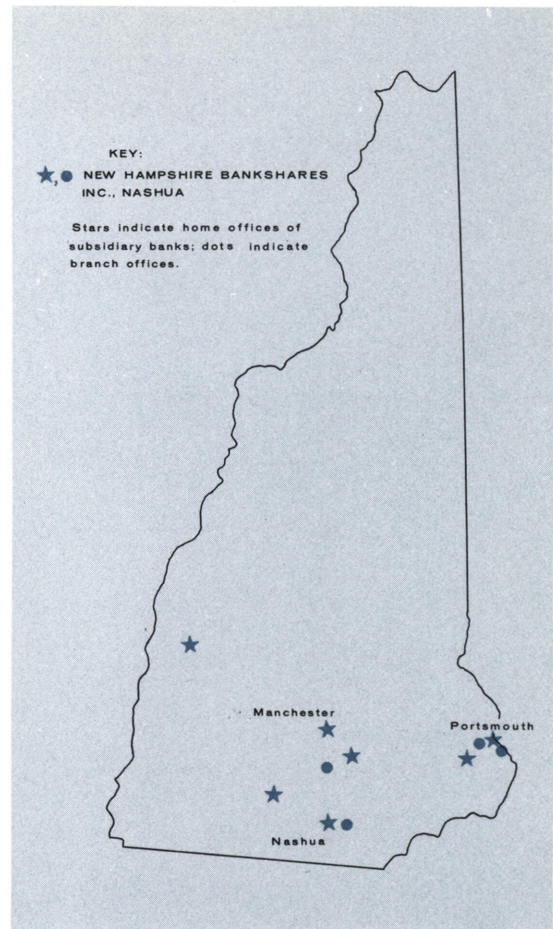
achieve direct representation in economic areas throughout the state. Individual banks are not permitted to establish branches outside of their home office county; this means that non-holding company Boston banks are unable to compete directly with offices in the rapidly growing suburbs. Map II shows that one holding company, the Baystate Corporation, has utilized this advantage more fully by acquiring subsidiaries over a broader area of the state. In contrast, the subsidiaries of Shawmut Association, Inc., are concentrated more heavily around Boston where the largest bank in the system is located. In the event that Massachusetts branching law is liberalized, either of these companies would be in a potentially very advantageous position. They could readily convert to regional or statewide branch banking systems by merging some or all of their affiliates.

(3) NEW HAMPSHIRE. Until October 1963 branch banking was prohibited in New Hampshire. Organization of New Hampshire Bankshares, Inc., presently the only registered bank holding company in the state, may have been motivated by the desire to establish multi-office banking. Before the law was changed the only way to accomplish this goal was via the holding company route. Even though branch banking is now permitted, it is very narrowly restricted, so that holding companies still offer significant advantages for geographical expansion. If current reports are accurate, two new bank holding companies may soon be organized in New Hampshire, with the result that roughly 25 percent of commercial bank deposits in the state would be controlled by holding companies.

Map III—NEW HAMPSHIRE BANK HOLDING COMPANIES



The Impact of State Branching Laws. Some of the New England holding company developments discussed above exemplify how restrictive state branching laws may stimulate the formation and expansion of bank holding companies. In states where branching is entirely prohibited, multi-office banking is possible only through holding companies, and where branching is permitted but subject to specific restrictions,[13] holding companies often provide a more flexible means (or the only means) of establishing a statewide, regional, or even metropolitan area banking system. The holding company route has proven particularly attractive to center city banks

[13]In "limited branching" states, branching may be restricted to one county, contiguous counties, a single city, some radial distance from the home office, etc. Even in some statewide branching states (such as Connecticut) branching may be limited by "home office protection" laws.

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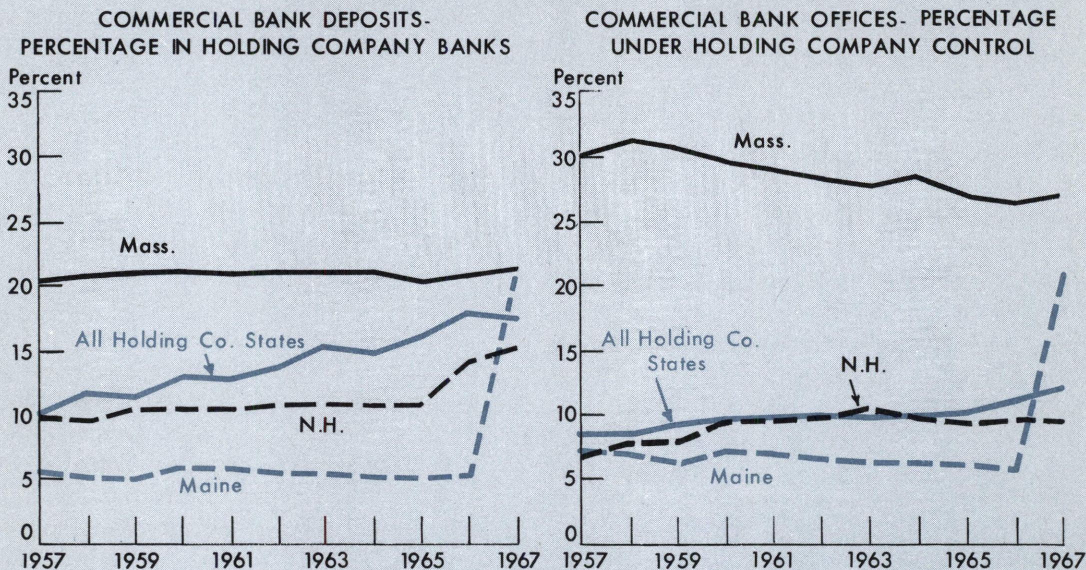

that lack the legal power to branch into growing suburban areas. Critics, usually independent bankers, have argued that holding companies are primarily a device for circumventing legal restrictions on branching.

The proposition that bank holding companies are most common and rapidly growing in states that prohibit or restrict branching is often stated, and is quite plausible. It has been noted, however, that holding company banking has developed to an important extent in several statewide branching states, suggesting that factors other than state law are influential — *e.g.* size of the state, historical considerations, and even such subjective factors as might apply, for example, to the current situation in Maine. It is not uncommon for holding companies to exist and have large branch bank subsidiaries in states where branching is unrestricted. In these cases, holding companies appear to serve as complements to branch banking rather than substitutes.

The figures in Table II are designed to shed some light on the relation between state branching laws and the importance of bank holding companies in terms of their share of total commercial bank deposits. Figures are presented for 1960 and 1967, and the change in the holding

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company share over that period is also shown. A year earlier than 1960 was not selected for comparison because adjustments to the 1956 law, mostly de-registrations of existing companies, were not entirely completed. The 1967 figures were adjusted to eliminate the effects of new registrations that resulted directly from the 1966 amendments changing the definition of holding companies in the Bank Holding Company Act; without this adjustment, the figures would be distorted since the affected companies had existed earlier, and an inflated 1967 figure would reflect legal rather than real changes. States where bank holding companies are illegal were eliminated from the sample.[14]

The figures show some interesting results. First, in statewide branching states, where the average holding company share of deposits was highest in 1960, the share declined between then and 1967. This decline reflects the fact that four important holding company states in this category have no in-state holding companies. Since there were no formations or new acquisitions during the period, holding company growth in these states represents only expansion of banks affiliated before 1956 with out-of-state companies. Bank holding companies have increased in importance in unit banking states, but by far their most impressive growth has occurred in limited branching states, where their average share of total commercial bank deposits increased by half (from 12.1 percent to 18.1 percent) between 1960 and 1967. If these results, based on recent bank holding company development, have any predictive value, they would support the expected trends previously described for the New England states: further growth of holding companies is expected in Maine, Massachusetts, and New Hampshire, but their development in Connecticut and Rhode Island seems unlikely.

[14]In some of these states holding company subsidiaries do exist; they are either part of in-state companies protected by a grandfather clause or banks acquired by out-of-state holding companies before 1956. In either case, any change in the holding company share of deposits would represent growth of existing affiliates rather than new holding company acquisitions or formations.

Table II

STATE BRANCHING LAWS AND CHANGES IN THE IMPORTANCE OF REGISTERED BANK HOLDING COMPANIES, 1960-1967

Type of State Branching Law	*Holding Company Share of Total Commercial Bank Deposits* 1960	1967	*Change in Holding Company Share, 1960-1967*
	Percent	*Percent*	*Percent*
Statewide Branching (14 States)	18.2	16.8	−1.4
Limited Branching (12 States)	12.1	18.1	+6.0
Unit Banking* (13 States)	16.2	19.0	+2.7

SOURCES: *Federal Reserve Bulletins* and data from the Board of Governors of the Federal Reserve System.

*Branching prohibited.

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Bank Holding Companies — Pro & Con

Restrictive state branching laws have undoubtedly fostered the growth of bank holding companies in some areas. Extension of holding company banking over integrated economic regions that cannot be covered by branch banking systems may yield desirable results. Proponents argue that bank holding companies offer significant benefits to the affiliated banks, to the communities served by them, and to bank stockholders. Their arguments, the case for bank holding companies, will be reviewed in this section.

Commenting on the passage of the Bank Holding Company Act of 1956, M. A. Schapiro & Co. noted that

> It is ironic that the Bank Holding Company Act of 1956 stemmed originally from efforts by independent bankers to remove the holding company from the banking scene; what has actually happened is that the holding company has received legislative approval. What some had hoped would be a death sentence turned out to be a passport to the future.[15]

In passing the 1956 Act, Congress recognized potential dangers of bank holding companies; but the "passport" would not have been issued if Congress had not also perceived that benefits to the public could be realized through holding company banking. Of course, holding company growth has been motivated by many considerations other than altruism; not all the advantages claimed by holding company advocates are relevant to public policy.

Advantages to the Public. A bank holding company may be able to assist an acquired bank in becoming a stronger competitor in its local area. Financial support and advice from the parent company may enable a small subsidiary to offer banking services which were previously unavailable to its customers, or to provide existing services at lower prices. For example, whereas a small subsidiary may not have the resources to operate a trust department on its own, it can offer trust services directly or indirectly through the holding company. Similarly, a subsidiary's ability to service large local customers can be facilitated by intra-system participation loans. The banking public gains directly if affiliation enables a bank to offer new or cheaper services or, in general, to become a stronger competitor in its area.

Holding companies often argue that affiliation can enhance a small bank's ability to supply needed loans to its community. The holding company can offer sound portfolio counseling, advice and assistance on special credit problems, and an opportunity to sell participations in larger loans to other banks in the system. As a result, the bank should be able to lend out a higher proportion of its deposits and therefore better serve the borrowing needs of its customers.

Overall allocation of credit is enhanced to the extent that participation loan transactions are utilized within a holding company system to channel excess funds to subsidiaries in areas where loan demand is high but the supply of funds is relatively low.[16]

Comparable allocative effects may arise in connection with bank capital. A holding company can generally raise capital more readily than a small independent bank; thus, it can obtain bank capital in a capital-surplus area and apply the funds to strengthen one of its banks in an area of capital shortage. A subsidiary's improved access to capital can benefit its customers by assuring the necessary expanding capital base

[15] M. A. Schapiro & Co., Inc., *The Triple Banking System* (New York, 1956), p. 18.

[16] Critics have argued that bank holding companies may consequently discriminate in favor of city affiliates and drain money out of rural or suburban areas.

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to support increasing loan and service needs of a growing community.

Advantages to the Banks Involved. Most bank holding companies include a dominant or "lead bank," usually a bank in a metropolitan center. As suggested above, the lead bank often organizes a holding company as a means of expanding into areas where it is not allowed to branch directly.

Holding company organization may be motivated, in part, simply by a desire to increase the size of a single banking organization. In some regions banks have banded together into holding companies in order to enhance their bargaining power in dealing with banks in major financial centers.

The opportunity to achieve gains in operational efficiency provides another impetus to bank holding company organization. Through the facilities of the lead bank, or through a separate non-banking subsidiary, a holding company can perform services for affiliated banks. Therefore banks joined in a holding company group can reap many of the benefits of branch banking while at the same time retaining some degree of local autonomy. Economies may be realized by centralizing or coordinating such operations as data processing, advertising, purchasing, portfolio management, auditing and preparation of tax returns. The holding company can pool specialized management talent and provide expert advice to individual banks on such matters as branch location decisions and special loan problems. As a result of these and other advantages, proponents claim that bank holding company subsidiaries can offer more services and operate more profitably than independent banks of a comparable size.[17]

Although holding company expansion is usually the result of a parent company actively seeking new affiliates, sometimes an independent bank will take the initiative and ask to be acquired. The bank may regard holding company affiliation as a convenient solution to problems such as providing new services in response to competitive pressures from larger banks, raising capital, or hiring specialized personnel, including successors for top management positions. It is often argued that one of a bank holding company's most important contributions is in easing bank personnel problems. The advice of holding company experts may be made available to subsidiary banks, as noted above, and the holding company can establish system programs for recruiting, training and shifting of management personnel among subsidiaries. Holding companies often offer more generous employee benefits than an individual subsidiary could afford or manage, and prospective employees may also be attracted by the greater opportunities for mobility and more rapid advancement in an organization that includes a number of banks.

Advantages to Bank Stockholders. Holding companies usually acquire control of a bank through an exchange of stock. When a bank is acquired by a bank holding company, its owners generally stand to gain on several counts. In addition to a capital gain on the exchange,[18] they receive holding company stock that is virtually always more readily marketable and often pays a higher yield than the individual bank stock that they give up, and they often enjoy a tax advantage as well. Moreover, since holding companies usually attain some degree of geographical diversification, their stock may represent a less risky, more stable asset than the stock of a single bank. It is not surprising, then, that some leading authorities have concluded that

[17]It should be noted that many of the advantages of holding company affiliation can be obtained through a correspondent. However, given the ownership link in a holding company organization, an affiliate might expect more dependable service, on a basis of greater certainty at all times, or more cheaply, than it could get from a correspondent.

[18]In some cases the capital gain may be quite substantial, even exceeding a 100 percent premium on market value.

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expected gains to stockholders have been the primary reason for independent bankers' decisions to join bank holding companies. Top managers of many banks are also significant stockholders; if they are considering the possibility of holding company affiliation, their management and ownership interests are generally complementary.

Arguments Against Bank Holding Companies. The Bank Holding Company Act contains provisions designed to prevent developments that gravely concerned opponents of bank holding companies, namely that they would lead to undue concentration of economic power and reduction of competition in banking. Much opposition to bank holding companies is apparently linked to a broader objection to any form of multi-office banking, and branch banking in particular. Although the Board of Governors has declared its opinion that holding company acquisitions are not subject to state restrictions on branching, critics sometimes maintain that holding companies are at least contrary to the spirit of branch banking laws.

The 1956 legislation is also intended to prevent certain kinds of abuses which drew notoriety to some holding companies in the past — *e.g.* using holding company control to dictate excessive dividend pay-outs by a subsidiary, manipulating accounts to reap promotional profits, and exploiting subsidiary banks in self-serving management deals. Given the Federal Reserve's present regulatory powers, objections along these lines are not important today with respect to registered bank holding companies.

A more relevant argument against bank holding companies is that "absentee control" over local banks may result in a diminished responsiveness to local credit needs. Holding companies usually *can* exercise effective control over the operations of their subsidiaries, whether or not they choose to do so. Despite the appearance of local autonomy, holding company control may in some cases lead to a loss of local initiative.

Organization and Operational Policies of Bank Holding Companies

The extent to which the potential advantages of bank holding companies are realized depends upon the organizational structure of a particular company and the manner in which the holding company renders services to its affiliates.

The autonomy of affiliates varies widely among holding companies. In some cases the parent company acquires and holds bank stock merely for investment purposes, while at the other extreme the holding company exerts substantial control over subsidiary banks' activities so that the system closely resembles a branch banking organization. The "typical" holding company lies between these two extremes. Generally, the holding company influences directly some broad policies of its bank subsidiaries, but lacks detailed control over daily activities.

An important question for policy purposes is whether bank holding companies should be regarded as a decentralized form of branch banking or as a cooperative association of essentially autonomous banks. Resolution of this question is important for bank regulators who must judge the competitive effects (*e.g.* in terms of concentration of banking resources or number of independent banking alternatives) in a given market area of proposed holding company acquisitions and formations or mergers involving existing holding company subsidiaries. The problem has been debated in the literature but never satisfactorily resolved. In fact, the only realistic answer is that no generalizations are possible.

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The actual degree of autonomy of a subsidiary bank depends upon the attitude of the parent holding company. To determine the extent to which an affiliate acts as an independent unit, it is necessary to examine the organizational structure of the particular holding company, including the various means of communication between the holding company and the affiliate and the types and extent of control exercised by the parent organization.

A study of the registered bank holding companies in the First District provides examples of the substantial differences that exist among holding companies in terms of their basic organization and operations. The following discussion illustrates how holding company control may be exercised through different organizational structures and operational policies with regard to certain bank and holding company functions.[19] Bank holding companies in New England run the gamut from a very loose organization, where the avowed purpose of the parent company is merely to advise and not to control, to a system where the holding company closely controls most important internal operations of subsidiary banks through frequent intra-system meetings, required reports and close supervision of policy. One First District system is unusual in that it contains no dominant "lead bank;" services to its subsidiaries are provided through a wholly owned subsidiary service corporation. More typically, in other companies expert advice is made available and services are rendered primarily through personnel and facilities of a lead bank.

Organizational Structure. A bank holding company may influence the activities of affiliates by having representatives on the affiliate's board of directors or in key management positions, or by effectively controlling the selection of these individuals. Control may also be accomplished through various formal and informal lines of communication between the subsidiary and the parent company or by requiring that the subsidiary consult the holding company on certain matters.

All New England bank holding companies emphasize the local character of their affiliates' boards of directors.[20] In one case, the only instance of common directors or officers is between the parent organization and the lead bank.[21] At the opposite extreme is a situation where the president of the lead bank is also president of all the other affiliates, and within the system there are additional cases of overlapping of key policy making personnel. It is common practice for the local bank to recommend candidates for directorships or top management positions and to at least clear its suggestions with the holding company. The company may insist on veto power over specific choices.

Even in cases where the holding company is not directly represented on a local board it may send representatives to attend the board meetings. This is one of several possible lines of communication that can be utilized in order to expose the subsidiary to ideas of the holding company or to improve the company's understanding of an affiliate's operations. Some companies have established formal committees to deal with specific operations or to serve as a forum for discussion among affiliate and holding company representatives of general "problems of mutual interest." Holding company spokesmen

[19]This section is based substantially on research carried out by Thomas H. Hodges, a former employee of this Bank's Research Department.

[20]Local board members are valued for special expertise and for the value of business they can bring to the bank. If a holding company wishes to influence a local board it will ordinarily retain these men but expand the size of the board by adding its own representatives.

[21]Two New England companies are unusual in that they provide for affiliate representation on the holding company's board.

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may participate simply in an advisory capacity, offering suggestions which the affiliate is free to accept or reject, or the meetings may be supplemented by audits or required reports that furnish the basis for specific recommendations from the company to the affiliate. There is obviously little need for formal communications in the one situation where the lead bank and affiliates have a common president. Expert advice from specialists at the holding company or lead bank is usually available through informal channels.

Holding companies generally expect to be consulted by their affiliates on such matters as changes in dividend policy, establishment of branches, or other factors that affect earnings. Two New England companies extend their influence over affiliates by requiring consultation on a much broader set of questions; in one instance, such restrictions apparently confine the autonomy of affiliates' operating officers to rather minor and routine matters.

Provision for Management. One potential advantage of bank holding companies is their ability to supply skilled management to subsidiary banks through recruiting and training programs and intra-system shifting of personnel. However, this potential has rarely been realized fully. Only one company in New England presently has a formal management training program, but its operation has not been successful; in practice, the company's policy has been to assist an affiliate directly, and therefore, to relieve the bank's need for management rather than supplying it. Although another company has a personnel committee, the committee has not been very active.[22] To the extent that most companies offer any sort of personnel assistance, it is ordinarily only on an informal basis, such as offering the facilities of the lead bank's personnel department for recruiting, or "lending" the services of a lead bank officer to an affiliate to solve a particular problem.

Investment Services. All but one of the bank holding companies in the First District offer investment counseling or complete portfolio management to their subsidiary banks. Nationally, this has proven to be one area of service which holding company organizations have utilized most successfully to the advantage and satisfaction of their affiliates. One company provides continuous supervision of each bank's portfolio and offers in addition a variety of investment services. In another case the lead bank's investment department periodically reviews the affiliates' portfolios and offers recommendations. The same service is offered on an identical basis to non-affiliated banks that have a correspondent relationship with the lead bank. Management of subsidiary bank portfolios is handled completely by the lead bank in two New England holding companies.[23]

Loan Policy. Bank holding companies generally seek to influence at least the general lending policies of their subsidiaries. They almost always review loan portfolios through special reports or audits, and some companies maintain complete central credit files. Subsidiary bank officers usually retain the authority to grant or refuse loans without interference from the parent organization, although the company may expect to be consulted before an unusually large or complicated loan is made. Many companies encourage affiliates to initiate or extend consumer instalment loan programs.

Among the First District bank holding companies, loan policy varies from nearly complete

[22]On several occasions a subsidiary bank has hired a management trainee from the lead bank, and management needs of affiliates have sometimes been met by movement of personnel within the group.

[23]In these cases this service is provided exclusively for affiliates, *i.e.*, it is not available to correspondents of the lead bank.

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autonomy for affiliates to fairly effective control by one company which maintains a central credit file and has organized special committees to coordinate instalment and participation loan programs. At least two companies set specific loan/deposit ratio targets for their subsidiaries; one aims for a minimum level of 65 percent and another sets a 75 percent maximum.

Bank holding companies generally have not exploited intra-system participation loans to their full potential. However, an exceptional case is one New England company which actively promotes and thoroughly supervises participation loans as a means of serving large customers of affiliated banks. The loans are usually arranged and originated by the lead bank, and participations with non-affiliated institutions are discouraged. No other New England holding company has developed participation loans to a very significant extent, although they may be "encouraged."

Correspondent Relationships. In order to minimize the non-earning assets of their subsidiaries, most bank holding companies discourage correspondent relationships with banks outside the system, unless, of course, such relationships are necessary to obtain services which the company cannot provide directly or through the lead bank. Two companies in the First District exercise complete control over the correspondent activities of their affiliates, and only one apparently leaves the matter entirely up to the individual banks.

Computer Services. Three New England holding companies offer their subsidiary banks convenient access to computer services, either through the facilities of the lead bank or, as in one case, through a computer center that is wholly owned by the participating banks. This service is made available to affiliates on a direct charge basis, and utilization is generally optional.

Trust Services. Affiliation with a bank holding company can enable even a small bank to offer trust services to its customers. The holding company may channel all trust business to the lead bank, or administration may be centralized while the affiliates nominally retain their own accounts. Alternatively, the holding company may offer assistance in trust administration, generally on a direct charge basis. Bank holding companies in this district provide examples of all of these arrangements.

Other Services. The variety of services that a holding company can provide to subsidiary banks is exemplified by the programs of one New England company. The company offers (on a voluntary basis) several employee benefit programs, a profit-sharing plan, a group purchasing program for supplies, equipment and insurance, preparation of tax returns by holding company specialists, compilation of statistical data for use in evaluating performance, and other services. Only one of the companies in this area has pursued an extensive program of coordinated advertising.

Holding company affiliates generally pay an annual management fee to cover the expenses of the parent organization. When services are rendered on an optional basis, the holding company is paid either directly or through compensating balances at the lead bank.

Regardless of significant differences in the organization and operations of bank holding companies, two common characteristics affect the relationship between the affiliates and the parent organization. First, a feeling of group identity, which more or less pervades any holding company organization, is conducive to close cooperation and common operational policies among subsidiaries even in systems where there is no structural compulsion to follow the leadership of the holding company. Secondly, no

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matter how much autonomy a holding company chooses to allow its subsidiary banks at a given time, its fundamental relationship to the subsidiaries remains that of principal stockholder. A holding company may limit an affiliate's autonomy at any time if it feels compelled to do so in order to assure continued profitability.

Performance of Bank Holding Company Affiliates

The various advantages and potential benefits of holding company banking have been described in the preceding sections of this article. The extent to which holding company affiliation actually benefits acquired banks or bank customers is of course an empirical question, and one which is of considerable interest to bank regulators. Previous studies have concluded that subsidiaries of bank holding companies are not fundamentally different from independent banks of a comparable size in the same area, either at the time of acquisition or after they have been affiliated for some time. As noted above, many of the advantages of holding company banking are available to independent banks through correspondents. Thus, despite the many claims of bank holding company advocates, "many of the virtues of this form of organization are far more imagined than real."[24]

In a recent study for the Board of Governors, Robert J. Lawrence analyzed the performance of bank holding company affiliates relative to comparable independent banks.[25] Examining a sample of banks acquired by holding companies between 1954 and 1963, Dr. Lawrence employed a statistical procedure which was carefully designed to isolate the impact of holding company affiliation on a series of variables selected to measure bank performance. The results of these tests show only a limited number of statistically significant changes in acquired banks' performance.

The most significant changes occurred in measures of acquired banks' asset structures. Lawrence found that, after acquisition, holding company banks achieve an increased ratio of total loans, and especially instalment loans, to total assets. Two other changes suggest that changes in investment behavior after affiliation may often increase the amount of bank credit available to the local community. Relative to independent banks, the acquired banks show increased holdings of state and local government securities and declines (as a proportion of total assets) in U.S. Government securities and currency plus balances due from domestic banks.

The ability of holding companies to ease an affiliate's management requirements by handling some operating functions on a centralized basis is indicated by the finding that after affiliation subsidiary banks show a lower ratio of officers to total employees. Somewhat surprising, however, is the absence of significant improvement in certain operating results. No significant changes were observed in the performance of affiliated banks relative to independent banks in terms of loan losses, capitalization, or average yield on the U. S. Government securities portfolio.

Probably reflecting the fact that affiliates' rates and charges are almost always determined locally, Lawrence found no significant differences in loan charges or interest rates paid to depositors; but he did discover an average increase in service charges on demand deposits. If affiliation enables a bank to offer more or better services, this advantage should show up in a growth rate exceeding that of independent

[24] Fischer, *op. cit.*, p. 86.

[25] Robert J. Lawrence, *The Performance of Bank Holding Companies* (Washington, D.C.: Board of Governors of the Federal Reserve System, June 1967).

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competitors. This was not true in the cases that Lawrence analyzed.[26]

An important conclusion of Lawrence's study is that holding company affiliation generally did not lead to increased efficiency or improved earnings performance by acquired banks relative to their independent bank competitors.[27] Operating revenues and expenses both increased significantly. Higher revenues apparently result from higher service charges as well as some substitution of loans for lower-yielding U.S. Government securities or for cash and other non-earning assets. Higher operating expenses apparently stem largely from the fees and charges levied by the parent company for services rendered.

Acquisitions in New England.[28] Ten bank holding company acquisitions took place in this district between 1956 and the end of 1967. In eight of these cases statistical data are available for a sufficient time before and after acquisition so that it is possible to analyze how the banks were affected by holding company affiliation. The applications were examined in each case in order to determine the major reasons for each acquisition. This review therefore provides an *ex post* check on a case-by-case basis on holding company claims of benefits *versus* actual results.

(1) Management. The need of a small bank to locate or train a successor for its chief executive officer was an important factor in 5 of the 10 holding company acquisitions, and the holding companies were evidently successful in each of these instances. In another case the holding company sought to recruit or train junior officers in order to provide greater management depth for an acquired bank.[29]

(2) Loan and Investment Policy. It has been argued that holding company advice and assistance can improve an affiliate's lending service to its community by encouraging it to loan out a higher proportion of deposits and to emphasize certain kinds of loans, especially consumer instalment loans and unsecured business loans. These changes in loan policy are consistent with the desire of bank holding companies to improve the earnings performance of their affiliates.

In all but two of the cases studied the acquired banks' loan-to-deposit ratio increased in the post-acquisition period. The percentage increases were generally not very large, however — the ratio increased by over 10 percent in only two instances.[30] The holding companies argued specifically in three applications that the banks they sought to acquire could expand consumer lending services as affiliates. For the group of acquired banks as a whole, the ratio of consumer instalment loans to total loans *decreased* after

[26]Two other studies arrived at different results.

First, in a cross-section study of paired holding company and independent banks in the Sixth District, Joe H. McLeary found that holding company affiliates generally charged lower rates on loans ("Bank Holding Companies: Their Growth and Performance," Federal Reserve Bank of Atlanta, *Monthly Review*, October 1968). Second, in his earlier study, Fischer (*op. cit.*, Ch. IX) found that rural subsidiaries of bank holding companies achieved more rapid growth of deposits and loans than their independent bank competitors. Neither of these authors employed the before/after technique of comparison utilized by Lawrence. (This methodological difference is recognized explicitly by McLeary).

[27]In his earlier study, Fischer found that banks acquired by holding companies typically did not gain in profitability relative to their competitors, except in cases where they had held excessive amounts of cash or government securities prior to acquisition. In fact, he found that profitability often declined in the short run.

[28]This section is based on a report prepared by Dorothy Bradley of this Bank's staff. Six of the eight banks studied had total assets under $10 million at the time of acquisition. Benefits of holding company affiliation are allegedly most likely to accrue to small banks such as these.

[29]Two of the acquired banks were subsequently merged with existing subsidiaries, partly to solve management problems, and another bank had already been under control of holding company personnel, so that in only 1 of the 10 cases was the management factor entirely absent.

[30]The most dramatic change was an increase in the ratio from .45 to .54, or by 21 percent. For one bank the ratio fell by 12 percent from .80 to .71.

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acquisition in all but two instances. Consumer instalment loans did *not* increase in proportion to total loans in any of the three cases where expanding consumer credit was emphasized in the holding company application. Business loans grew significantly as a proportion of total loans in one bank after acquisition and declined substantially in another. Otherwise, the study did not reveal any significant impact of holding company affiliation on the business loan policies of acquired banks.

The New England cases confirm that holding company affiliation often has an important effect on the structure of acquired banks' non-loan assets. In all but one of the cases, currency plus deposits due from other banks declined relative to total assets in the post-acquisition period, reflecting a switch to loans and other more profitable earning assets. The acquired banks also reduced their holdings relative to total assets of U. S. Government securities in most cases, and sometimes very significantly. They also typically increased their holdings of securities issued by state and local governments. In several cases, state and local government obligations were apparently substituted for U. S. Government securities; they are, after all, close substitutes as low-risk investments. Such substitution may result from portfolio counseling furnished by the holding company, and it may reflect an effort by the companies to encourage acquired banks to hold state and local issues as a public service to the areas they serve.

(3) Capital and Earnings. Although holding companies often argue that they can provide subsidiaries with improved access to capital, holding company acquisition does not seem to have affected the average rate of growth of total capital accounts of the banks involved in the cases studied. Moreover, the bank regulatory agencies have not given very high ratings to the capital positions of the banks acquired by New England holding companies. Of the 10 banks acquired from 1956 through 1967, five are presently rated as "marginal," four "adequate," and only one "good" in terms of "capital adequacy." Evidently, the bank holding companies generally have not felt that more capital is needed for these subsidiaries; at least their capacity to raise more capital for the acquired banks has not been exercised effectively in these cases.

Comparative figures also fail to indicate any significant overall impact of affiliation on the earnings performance of acquired banks. One quite impressive gain was noted, but otherwise the rate of return on capital was hardly different at all in the post-acquisition period. It should be noted, however, that these comparisons cover 3 years or less, and the effects of holding company affiliation on both earnings and capital positions may show up only after a longer period of time.

This review suggests that the advantages of holding company affiliation have only been partially realized in the First District acquisitions since 1956. Management problems have provided impetus for acquisitions, and several acquired banks have benefited from holding company assistance in this area. Whether or not the banks could have solved these problems on their own has not been demonstrated. To the extent that acquired banks have increased their ratios of loans to deposits, the communities they serve have benefited. Some discernible changes in asset structure have been observed fairly consistently, mostly to the advantage of the affected banks, but, in general, affiliation has not produced significant changes in the capital positions or earnings of the acquired banks.

Federal Reserve Regulatory Policy

Over the years since 1956 the policy of the Board of Governors toward bank holding company formation and expansion has become clearer as the body of precedents has grown.

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Of necessity, the Board's policy was first articulated in fairly general terms, emphasizing a relationship between banking market structure and competitive results. The Board has endeavored to develop consistent standards in weighing the merits of each case according to the broad statutory criteria of the Bank Holding Company Act, namely the traditional "banking factors," the convenience and needs factor, and the competitive factor.[31] The Board's treatment of individual cases has become increasingly sophisticated over time, reflecting the results of continuing research and the accumulation of experience. Policy in the future may be expected to focus to an increasing extent on past performance of bank holding companies and on the differences in organization of specific systems.

The table below shows the record of the Board's actions in cases of registered bank holding company formation and acquisition for the recent period of January 1967 through early December 1968. The denial rate may appear quite low, but it should be noted that in earlier periods the rate of denial was approximately four or five times as high. The lower rate in the recent period undoubtedly reflects the clarification of the Board's policy since 1956; many proposals of the sort that were denied in earlier years are not even submitted today or are dropped by the applicants as a result of consultation with the Federal Reserve System before an application is formally filed.

Formations	*Approved*	*Denied*
No. of Cases	18[32]	1
No. of Banks Involved	42	2
Acquisitions		
No. of Cases	35	4
No. of Banks Involved	39	4

[31]As noted in the Appendix, these factors are not enumerated separately in the law as amended, but they are given individual attention in the Board's decisions, all of which are published in the *Federal Reserve Bulletin*.

[32]This count excludes one new registration which reflected only a reorganization of an existing holding company rather than creation of a separate new system.

In New England, two registered bank holding company formations and acquisitions involving 15 banks have been approved by the Board since 1956, and no cases have been denied. This enviable record has been achieved by First District holding companies essentially because their proposals to date have not, in the Board's judgment, involved serious anticompetitive effects. In one acquisition, the Board recognized probable benefits in solving a serious management problem (a "banking factor") through holding company affiliation, and two other cases were considered to offer possible convenience and needs gains to the communities served by the acquired banks. In none of these instances, however, would the application have been approved if the competitive effects of the acquisition had been regarded as adverse. Two acquisition cases were very close ones. In one, the acquired bank was to become the largest bank in its region after a merger (with another subsidiary) that was scheduled to follow the holding company acquisition. In the other, the acquired bank was the largest commercial bank in its county. The acquired banks in virtually all the other cases were relatively small institutions in their respective market areas.

This brief review of the Board's actions in New England holding company cases indicates the broad outline of its general policy position. The policy record of the Board has been examined in detail elsewhere, so that only a short summary is necessary here. The "banking factors" have affected decisions only in rare instances. Convenience and needs benefits to the public must be compellingly demonstrated by the applicant before this factor is accorded any significant weight in the Board's decisions. The competitive factor has always received the major emphasis, and this has been increasingly true in recent years. The key issue considered by the Board is the expected impact of a bank holding company formation or expansion on the banking structure of a state or specific area.

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The "Banking Factors." Considerations relating to the solvency of an acquired bank are rarely important in the Board's decisions. Benefits from affiliation which would accrue specifically to the *banks* involved are usually ignored, despite possible indirect gains to the public. The occasional exceptions generally occur in cases involving small rural banks, where, for example, a holding company may offer a solution to management difficulties that are apparently insoluble by other means.[33]

Convenience and Needs. The relatively few cases in which the Board accords significant weight to the convenience and needs factor are usually cases in which the acquired bank is quite small and offers a limited range of banking services. Even in these instances, the applicant must demonstrate that there is an important unmet need for banking services in the affected area and that the services cannot otherwise be supplied by the acquired bank or other banks in the area. This factor has received greatest weight in cases involving organization and acquisition by a holding company of a new bank.

The Competitive Factor. In evaluating the competitive effects of proposed bank holding company formations and acquisitions, the major concern of the Board has been with the structure of local banking markets. No specific rules have been developed defining "undue" market power of a holding company or setting limits on expansion in a given area. However, three types of considerations figure prominently in the Board's evaluations of the competitive factor. (1) Competition, both present and potential, among proposed subsidiaries is a key issue. This is generally measured by proximity of subsidiary banks or estimated overlap in their geographic market areas. Therefore, an application for acquisition is likely to be rejected if the holding company already has an affiliate in the general market area concerned. (2) The Board considers the effect of proposals on banks competing in affected market areas. If a bank to be acquired is relatively small in its area, the Board may view the acquisition as pro-competitive if affiliation is expected to help a small bank become a more effective competitor against larger rivals.[34] (3) The Board has also demonstrated a concern for preserving a reasonable number of independent alternative sources of banking facilities and services in any given market area.[35] Other competitive aspects which the Board has considered include the impact of a proposal on concentration in particular banking markets, on present or future trends in banking structure changes, and on correspondent banking competition. In some cases the Board has evinced an apparent concern about the size *per se* of proposed or existing holding companies.

Nonbanking Subsidiaries. Since the Board's policy regarding nonbanking subsidiaries became clear quite soon after passage of the 1956 law, there have been relatively few cases on this question. The statute specifies that activities of nonbanking subsidiaries must be restricted to business that is a "proper incident" to banking

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[33]Some applications have been approved despite competitive problems in situations where the acquired bank is in such a weak condition that it might otherwise be forced to liquidate. Such a situation obviously affects the convenience and needs and competitive factors in that the acquisition effectively preserves a banking facility in the affected community. This is only one instance of overlap among the various "factors" that enter the Board's decisions.

[34]The Board has been accused of protecting existing competitors in some past cases when it has denied holding company applications. Some critics have claimed that in particular instances the Board has failed to distinguish between injury to existing banks that may result from enhanced efficiency of a bank (as a result of affiliation) as opposed to monopoly power exercised by a holding company system.

[35]This consideration is important to banking agencies in their rulings on proposed mergers between existing affiliates of a bank holding company. In the past there has perhaps been a tendency to approve cases involving common ownership in too perfunctory a manner. Significant differences may exist between the policies of two affiliates — *e.g.* a given loan request may be rejected by one but accepted by the other. In this area, a knowledge of the organization and operational policies of specific companies is especially important.

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or banking management, or financial, fiduciary or insurance in nature. In its early interpretations, the Board further required that banking and nonbanking activities of a holding company must be functionally interrelated and that intra-system dealings must constitute a large part of the business of nonbanking subsidiaries. Restrictions on the nonbanking activities of banks and registered bank holding companies have led to a recent upsurge of interest in one-bank holding companies.

One-bank Holding Companies — The Current Controversy

Federal law and bank regulatory practice have traditionally sought to draw a line between banking and nonbanking activities. The rationale for this policy is protection of depositors from nonbanking involvements and possible abuses that might impair the solvency of banking organizations. The present restrictions on nonbanking activities of registered bank holding companies have been noted above, but these limitations do not apply to one-bank holding company organizations. Of course, the banks involved are operated subject to the banking laws and regulation by the banking agencies, but the one-bank holding companies themselves are outside the control of bank regulatory authorities.

A great number and variety of one-bank holding companies exist in the United States. The count of these organizations already established or recently proposed is rapidly approaching the 800 mark. Many "traditional" one-bank holding companies have operated for a long period of time and have attracted relatively little attention or controversy. Most commonly they are closely held corporations that have been set up to provide a convenient means of combining management and ownership of small banks and to realize certain tax advantages. In many instances, these organizations control nonbanking firms such as insurance, finance, real estate or investment companies in addition to a single bank. Some nonfinancial corporations have operated single banks for many years primarily as a service to their employees. Other examples of long-standing one-bank holding company organizations include charitable trusts, labor unions, and nonprofit foundations that control banks under a variety of special circumstances.

In combination, the large number of "traditional" one-bank holding companies have considerable political influence. Although the Federal Reserve Board and other proponents of bank holding company regulation have long sought regulatory control of *all* bank holding companies, Congress has adopted and retained the one-bank exemption in the Bank Holding Company Act. Recent developments, however, have renewed Congressional and regulatory agency concern about one-bank holding companies. Interest in regulating one-bank holding companies has revived as a result of the acquisition of banks by several nationally prominent conglomerate corporations and particularly as a result of the decision by many large independent banks to reorganize as one-bank holding companies. Both of these trends have given rise to one-bank holding company organizations that differ markedly from the "traditional" mold. Many possess vast economic resources and actually or potentially combine a wide variety of nonbanking or even nonfinancial activities with the conventional "business of banking."

Financial Congenerics. One-bank holding companies have been prominent in the financial news lately because of the extraordinary development of "financial congenerics." This term has commonly been used to describe one-bank holding companies that are organized *by a bank*, with the bank as the principal subsidiary and with the intention of forming additional sub-

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sidiaries in order to engage in any number of *financially related activities*. The first such bank-dominated one-bank holding company was formed less than 2 years ago, and the number of these companies that have been established or proposed has increased at a rapidly accelerating pace. By the end of 1968, over 80 banks, including some of the largest in the United States, were either operating or planning to reorganize as one-bank holding companies.[36] Together, these banks represent over 23 percent of the Nation's commercial banking resources; their deposits exceed by a considerable margin the total deposits of all banks affiliated with registered bank holding companies.

One essential factor underlies the unprecedented flurry of one-bank holding company formations: banks are seeking greater freedom of action in serving the changing financial needs of their customers and in competing with nonbank financial concerns that can offer a full range of financial services other than depository facilities. The bank-dominated one-bank holding company organization provides greater flexibility and new sources of potential earnings by facilitating expansion into new product lines and geographical areas. Financial congenerics will be able to enter any number of financially related fields by establishing or acquiring subsidiary companies. Nonbanking activities that have been specifically mentioned include mutual funds, data processing, messenger services, leasing, factoring, specialized land development and mortgage financing and services, travel agencies, credit cards, investment counseling, brokerage and underwriting of securities, loan-related insurance, and many others. Previous attempts by banks to enter some of these fields have been frustrated by lawsuits initiated by nonbank competitors and by conflicting interpretations of courts and regulatory authorities regarding the proper scope of the "business of banking." Indirect entry via the one-bank holding company route enables banks to avoid legal or regulatory challenges entirely. Furthermore, since subsidiary companies are not restricted by state branching laws, these services can be offered directly anywhere in the Nation.

[36]Plans for all but eight of these companies were first announced during the last half of 1968.

Public Policy Concern. As more and more banks have become involved in conglomerate or congeneric organizations, Congressional and regulatory concern about maintaining the traditional separation between banking and commerce has increased. Just as Federal law places no restrictions on acquisition of a single bank by nonbank companies, there are no legal limits on the types or number of businesses that a bank-dominated one-bank holding company may acquire. The combination of banking and nonbanking operations under a single management raises some serious potential dangers to the public interest, problems which are a matter of public policy concern whether the organization is conglomerate or congeneric.

A primary concern, as indicated above, is that inter-affiliate transactions might endanger the solvency of the bank, *e.g.* if preferential and possibly unwarranted loan terms are extended to nonbank affiliates or their customers or suppliers. A variety of possibilities for self-dealing and tie-in arrangements exist, and there is serious question as to whether present regulatory powers are adequate to detect such abuses. Fears have also been expressed about possible excessive concentration of economic power in one-bank holding companies. Even though only a single bank is involved, the fact that closely related companies can be combined in the same organization means that potentially independent sources of financial services may be eliminated. Antitrust and banking laws are designed to protect against dangers such as these, but with the growing involvement of banks in conglom-

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erate and congeneric companies, additional safeguards may be needed. The newly formed financial congenerics have not given much indication of what their future plans will be, and little is known about the true motivation underlying the acquisition of banks by large conglomerate concerns.[37]

Another concern is that the development of financial congenerics will vastly increase the competitive advantage of large banks over smaller banks that lack the financial or managerial resources to develop a wide range of services through a one-bank holding company organization. Smaller banks that jump on the bandwagon with hastily conceived one-bank holding company plans might ultimately encounter difficulties if their resources are spread too thin.

The rise of financial congenerics poses other questions of competitive inequality. Among financial institutions, commercial banks alone have access to "cheap" money in the form of demand deposits. This could constitute a significant advantage to banks expanding into a broad range of financial services via the congeneric route. Registered bank holding companies have urged the Board of Governors to liberalize the rules regarding their ownership of bank-related businesses. Under the present framework, the choice is between multi-bank holding companies with strictly limited nonbanking activity or organizations with unrestricted diversification potential but only one bank. Some critics, including many independent bankers, complain with some justification that banks should not be permitted to do indirectly what they are not permitted to do directly. These inequalities can be resolved only by broadening the range of activities permitted to banks and registered bank holding companies or by somehow restricting the activities of one-bank holding companies. In order to put all banking organizations on a consistent competitive basis, a top priority, in the words of Chairman Martin, is "to get a legislative definition of what is financial and what is nonfinancial and to get an outline of what comprises banking."

[37]Typical public statements urge that bank acquisitions have been made by conglomerates "for investment purposes" or "to strengthen the bank," but one cannot help but wonder in some cases if there is not more to it than that.

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APPENDIX:
Development of Federal Bank Holding Company Legislation

Bank holding companies first emerged as an important phenomenon in American banking during the 1920's. By the early 1930's, Congress and the Federal banking agencies became increasingly concerned about their complete lack of control over bank holding company operations. Extensive Congressional hearings and investigation beginning in 1930 led to the first Federal controls, which were incorporated as part of the Banking Act of 1933 (Glass-Steagall Act).

Banking Act of 1933

Under this legislation, the Federal Reserve Board was granted limited powers to regulate certain bank holding companies. The scope of regulation was severely restricted in that the Act applied only to companies holding a majority of the stock of a Federal Reserve member bank or in any way controlling the election of a majority of its directors. In those cases where the Board's jurisdiction was established, it was authorized to examine the holding company and its subsidiaries, to set certain reserve requirements and to supervise other financial policies in the interest of protecting depositors. Bank holding companies covered by the law were required to obtain permission from the Federal Reserve before voting their stock in subsidiary banks. Denial of a voting permit was the only regulatory weapon available to the Board, and many bank holding companies were able to avoid regulation entirely by exercising control with less than majority ownership or without voting stock in majority-owned banks, or by controlling nonmember bank subsidiaries (in some cases withdrawing banks from membership in the Federal Reserve System).

Many Congressmen and banking agencies were soon dissatisfied with the limited effectiveness and scope of the Board's regulatory authority under the 1933 Act. Some stringent legislative proposals were eventually introduced, including recommendations to prohibit bank holding company formation or expansion, to curb branching by holding company affiliates, and even to abolish existing companies. In its *Annual Report* for 1943, the Board argued that the 1933 statute failed to achieve two essential purposes. First, the Board had no authority to control holding company expansion, even across state lines, and the Act gave no attention to the possible concentration of economic power in large holding companies or adverse competitive effects in specific areas. Second, there was no limitation on the combining of banks and nonbank business activities[1] under holding company management. The Board held that it was "axiomatic that the lender and borrower or potential borrower should not be dominated or controlled by the same management."

Over the years 1933-1956, unregulated growth of large bank holding companies was particularly rapid in some Western and Midwestern states, notably where branch banking was prohibited or quite limited. Although some critics pointed to isolated past abuses in bank holding company organizations, the prevailing Congressional and regulatory agency sentiment was that bank holding company development was *potentially* dangerous to the public interest unless more extensive controls were granted to the banking agencies.

In 1948 the Board initiated proceedings against the Transamerica Corp., claiming violation of the Clayton Act by virtue of the company's extensive control of commercial banking in a five-state area of the West. Transamerica owned and operated a wide variety of nonbank businesses in addition to 47 banks at the time the Board took its action. Although the Board ultimately lost the case in the courts (in 1953)[2] the proceedings attracted a lot of public attention. Fifteen bank holding company bills were introduced in Congress between 1949 and 1956, and extensive hearings began in 1952, leading finally to new legislation in 1956.

Bank Holding Company Act of 1956

The principal purposes of the Bank Holding Company Act of 1956 are to define bank holding companies, control their formation and expansion and require divestment of their nonbanking interests. In this first comprehensive bank holding company control legislation, Congress clearly evinced a concern for the competitive consequences of holding company development and a desire to prevent excessive concentration of economic power in bank holding companies. By choosing, after years of controversy, to regulate bank holding companies rather than abolish them, Congress recognized bank holding companies as a legitimate form of banking organization whose development, under supervision, could yield benefits to the banking public. The major provisions of the Act are summarized below.

Definition. A bank holding company is defined in the Act as any company (corporation, business trust, association, or similar organization)

> (1) which directly or indirectly owns, controls, or holds with power to vote, 25% or more of the voting shares of each of two or more banks, or (2) which controls the election of a majority of the directors of two or more banks, or (3) for the benefit of whose stockholders, 25% or more of the voting shares of each of two or more banks is held by trustees.

Notable differences from the definition in the Banking Act of 1933 are that the 1956 law covers nonmember banks, it lowers the index of "holding" from majority to 25 percent control, and its coverage is specifically limited to companies controlling at least two banks. The 1956 Act contains exemptions for banking chains and for various types of "companies"; for example, certain non-profit organizations are excluded. Companies falling under the statutory definition are required to register with the Board of Governors, to disclose

[1]The Banking Act of 1933 called for the separation of banking and only one nonbanking business — dealing in securities.

[2]Even though the Board lost its case against Transamerica, in the process, the Court of Appeals ruled that Section 7 of the Clayton Act was broad enough to encompass acquisition of bank stock by a holding company such as Transamerica. (This decision was later indirectly affirmed by the Supreme Court when it denied certiorari to the Board's appeal.)

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prescribed information in reports to the Board, and to submit to examination by the Federal Reserve System.

Actions Requiring Prior Approval by the Board. Prior approval by the Board of Governors must be obtained before any action is taken which would result in the formation of a bank holding company. The Board's consent is also required before a bank holding company may acquire over 5 percent of the voting stock (or substantially all the assets) of any bank,[3] or before two bank holding companies may merge. In deciding whether to grant approval for these actions, the Board was required to consider five factors:

> (1) the financial history and condition of the company or companies and the banks concerned; (2) their prospects; (3) the character of their management; (4) the convenience, needs, and welfare of the communities and areas concerned; and (5) whether or not the effect of the acquisition or merger or consolidation would be to expand the size or extent of the bank holding company system involved beyond limits consistent with adequate and sound banking, the public interest, and preservation of competition in the field of banking.

The first three factors essentially represent an evaluation of solvency, which was the main concern of the relevant provisions of the Banking Act of 1933. The last two factors represent significant new departures, requiring consideration of possible benefits to the public and expected effects on banking competition.

Separation of Nonbanking Activities. Under the 1956 Act a registered bank holding company is prohibited from engaging in any business other than banking, managing banks, or providing certain services to subsidiary banks. Subject to a variety of detailed exceptions, a bank holding company may not acquire or hold shares in any company which is not a bank. Some important exceptions apply to holding company ownership or control of companies engaged solely in activities closely related to banking or to the operations of the holding company and its subsidiaries, and to situations in which ownership of nonbanking assets is not regarded as violating the purposes of the Act.

Expansion Across State Lines. A bank holding company may not acquire a bank located outside of the state in which it conducts its principal operations unless such an acquisition by an out-of-state holding company is specifically permitted by statute of the state where the acquired bank is located. Since no state has enacted the stipulated permissive legislation, interstate expansion by bank holding companies is effectively prohibited, although holding companies operating across state lines at the time the Act was passed were allowed to continue their operations.

Restrictions on Lending and Credit Operations. Section 6 of the 1956 Act prohibited a bank holding company from borrowing funds from a bank subsidiary and severely limited or prohibited many kinds of loan or credit transactions among subsidiaries of a given system.

Even before the Bank Holding Company Act of 1956 was signed into law, the Board of Governors had expressed objections to some of its features, notably the two-bank definition and the inter-subsidiary loan restrictions of Section 6 (which effectively made participation loan operations more difficult for holding company affiliates than for banks dealing with a correspondent). The President signed the bill reluctantly, noting that "the exemptions and other special provisions will require the further attention of Congress." Despite repeated pleas by the Board of Governors in favor of amendments, no changes in the law were enacted until 1966.

The 1966 Amendments

In ruling on applications for prior approval of bank holding company formation and expansion, the Board of Governors encountered a difficult problem in weighing factors (4) and (5) of the statutory criteria. These criteria were couched in such vague language that it was extremely difficult to interpret Congressional intent in cases where an acquisition involving some anticompetitive effects was at the same time expected to benefit the "convenience, needs, and welfare" of the affected community. The same difficulty arose in the banking agencies' rulings under the Bank Merger Act of 1960. In 1966 both laws were amended to contain identical new criteria. The agencies were directed to continue consideration of the traditional "banking factors" (*i.e.* the first three factors in the 1956 Act) and the "convenience and needs" factor, but emphasis was explicitly placed on the prevention of adverse competitive effects. The law now proclaims that in judging proposed holding company formations and acquisitions the Board "shall not approve —"

> (1) Any acquisition . . . which would result in a monopoly, or which would be in furtherance of any combination or conspiracy to monopolize or attempt to monopolize the business of banking in any part of the United States, or (2) Any other proposed acquisition . . . whose effect in any section of the country may be substantially to lessen competition, or tend to create a monopoly, or which in any manner would be in restraint of trade, unless it finds that the anti-competitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served.

Several other Federal Reserve recommendations were enacted as amendments in 1966. One of the most important was the elimination of the Section 6 restrictions which hampered legitimate loan participations among bank holding company affiliates. Several special exemptions in the law were eliminated. However, the exemption for banking chains was retained, and, more importantly despite strong pleas by the Board of Governors, the Act's definition was not broadened to encompass one-bank holding companies. Retention of the two-bank definition is logically inconsistent with the objective of separating completely banking and nonbanking interests, but this objective was apparently subordinated to practical and political considerations. At the time the amendments were being considered, 586 companies, many of them quite small, were reportedly engaged primarily in nonbanking business and at the same time also owned one bank. Spokesmen for many of these companies claimed that divestiture of their banking interests would cause considerable practical difficulties and hardship; and no significant amount of evidence on one-bank holding company abuses was presented in the hearings. Presently, one-bank holding companies are effectively unregulated.

[3] Exceptions to the requirement of prior approval for bank stock or asset acquisitions are provided, for example, in cases where such acquisitions occur in a fiduciary capacity or as temporary holdings received in the regular process of handling a debt previously contracted, or in instances where the company already controls a majority of a bank's voting shares.

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Increasing Job Opportunities in Boston's Urban Core

By Carol S. Greenwald and Richard Syron

Providing good paying jobs is a major means of raising the incomes of the poor. Job opportunities can be expanded by bringing industry into the urban core and by making transportation available to take the poor out to suburban industrial plants. This article will examine both these means of job creation in relation to the Roxbury area of Boston. The possibility of increasing industrial jobs in the Boston core by building new industrial facilities will be examined by considering the availability of industrial site locations in Roxbury. The initial results of Boston's "Employment Express" — an experimental program of busing Roxbury residents to the industrial parks on Route 128 — provide insights into the potential of this type of program for expanding job opportunities for the urban poor.

Roxbury is an area within the City of Boston located about 3 miles south of the Boston central business district (see Map I). Originally a middle class suburb, Roxbury has become a blighted, low income neighborhood. Physical deterioration in Roxbury has been accompanied by a sharp decline in population and a marked shift in racial composition. Between 1950 and 1964, the population of Roxbury dropped 36 percent, from 109,000 to 70,000 and the nonwhite proportion of the population increased from 18 percent to 65 percent. Economic decline has been widespread. Vacant commercial establishments and dwellings, uncared for tax-title properties and rubble of demolished buildings scar the streets. Roxbury is presently designated a Model Cities area and an attempt is being made to redevelop it under the Demonstration Cities and Metropolitan Development Act of 1966.

Any effort to improve the living conditions of the urban poor must consider ways of expanding job opportunities. Attracting industry to Roxbury would be one means of raising incomes. An economic development program for Roxbury that involves building new industrial facilities must face the problem of finding industrial sites to build on. The Federal Reserve Bank of Boston undertook a study to determine whether a sufficient number of suitable sites are available in the Roxbury area to make an industrialization program feasible. The study indicated that without public aid, site costs and sizes would pose a significant barrier to industrial location in Roxbury.

At present only a limited area is zoned for industrial use,[1] primarily in the northernmost section of Roxbury. With the help of the Boston Redevelopment Authority (BRA), the Massachusetts Department of Commerce, the City of Boston Department of Real Property and commercial realtors, the Bank was able to compile a listing of all vacant land in industrially zoned areas of Roxbury and the adjacent South End.

As of July 1968, 29 vacant sites, totalling about 1.7 million square feet (39.3 acres), were zoned for industry in this area.[2] Most of the

[1]In this study, land zoned for industry included land in both zone classifications M (manufacturing) and I (industrial).

[2]This figure includes a few parcels of land not presently vacant, but which the BRA has plans to acquire and are uncommitted to a private developer.

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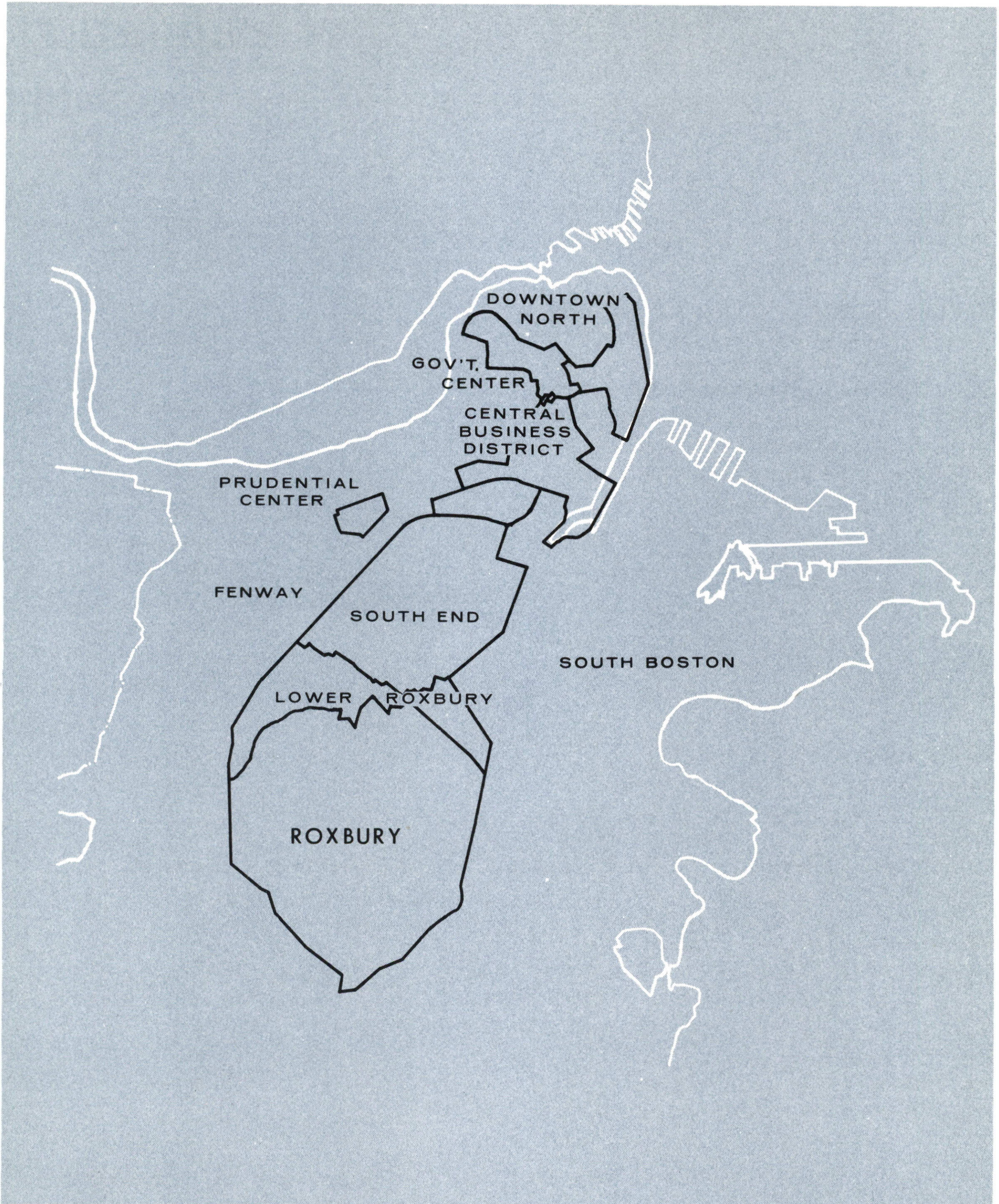
Map I — ROXBURY AND DOWNTOWN BOSTON



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unoccupied land was located in the South End. While the total amount of vacant land was substantial, the individual vacant parcels were quite small. As Table I indicates, there were only three sites between 2 and 5 acres and only one site larger than 5 acres. That one, located in the South End, includes 11.7 acres. Few firms will consider a site less than 2 acres, and if allowance is made for expansion, most will want more than 5 acres.

Another 750,000 square feet (17.1 acres) of industrial floor space was also found to be available in the Roxbury-South End area. Some of this floor space might be adequate for firms willing to locate in existing structures. Alternatively, if a building is largely vacant, it might be bought fairly readily and demolished to provide a site for a new plant.

The scarcity of large sites of vacant land as well as Roxbury's close proximity to the central business district and its excellent access to rail and highway networks makes land suitable for industry expensive. The price per square foot of land in Roxbury ranges upward from about $1.00 a square foot, several times the cost of land in suburban areas. The high cost of land in this area is partly accounted for by the demand for sites by truckers and warehousers who need storage and parking facilities close to highways and downtown Boston. The price of land in Roxbury, however, also appears to be bid up by speculators holding on to unoccupied sites in expectation of redevelopment of this area. This would seem to be the only plausible economic explanation of why vacant land selling at a high price is found adjacent to tax-title properties.

Land availability and site cost are serious obstacles to private industrial development in Roxbury. Without public aid there will be little economic motivation for more labor intensive industries to locate in this area.

Table I

AVAILABLE LAND FOR INDUSTRY

Section	*South End Urban Renewal Area*		*Roxbury*[1]		*Total*	
Site Size	*Square feet*	*Number of sites*	*Square feet*	*Number of sites*	*Square feet*	*Number of sites*
Less than ½ acre	93,362	6	46,227	4	139,589	10
More than ½ acre Less than 2 acres	325,752	7	313,957	8	639,709	15
More than 2 acres Less than 5 acres	160,000	1	261,360	2	421,360	3
More than 5 acres	511,000[2]	1[2]	0	0	511,000	1
Total	1,090,114	15	421,544	14	1,711,658	29

[1]By Roxbury, we mean all of Roxbury and that part of North Dorchester in the Model Cities area.

[2]This site is not entirely vacant at present, but the Boston Redevelopment Authority intends to acquire the area.

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While preserving the basically residential character of the Roxbury community, public policy could facilitate the expansion of job opportunities for Roxbury residents through urban renewal programs in the Lower Roxbury area. (See Map I.) That area, unlike most of Roxbury, is largely an industrial and commercial district. East of the Dudley Terminal business section is a prime area for industrial redevelopment. It contains some land now vacant, in tax-title, or occupied by deteriorated buildings.[3] Many of the remaining industrial sites are in low intensity general industrial use, such as warehousing and storage, or are used as parking lots. The City should consider whether a better use of the land would result from relocating some of the present businesses in the area and acquiring land in Lower Roxbury to provide the site for a modern industrial park. Industries locating here would not only provide jobs for the poor, they would also be highly accessible from all parts of the metropolitan region. Lower Roxbury is adjacent to both the Southeast and Southwest expressways as well as railroad lines and is served by MBTA buses and subways. In addition, the proposed inner belt highway system would run on the perimeter of this area.

An industrial jobs complex in Lower Roxbury is a possibility only with public direction and aid. As the Bank's study showed, available sites are too expensive and too small to attract private developers. Through urban renewal programs, however, the City can acquire land and lower its costs to private developers. The City could purchase the presently underutilized industrial sites, assemble an area large enough for an industrial park and then sell the land at less than acquisition and clearance costs to private firms who will develop it along lines planned by the City. Under Title I of the Housing Act of 1949, the Federal Government will reimburse the City for two-thirds of the difference between its site costs and the revenue obtained from selling the land. The State of Massachusetts will pay half of the City's remaining costs.

While urban renewal action can lower site costs and increase available site sizes, these are not the only impediments preventing firms from locating in Roxbury. The general trend throughout the United States has been for industry to move out of the central city. Attempts to counter this trend by urban renewal programs seem socially desirable, but will be difficult to achieve. There are real economic forces behind industry's flight from the cities. Urban renewal programs, in addition, take several years to complete. Attracting industry to the urban core, therefore, must be considered a long-run project.

A more immediate means of expanding job opportunities for the urban poor is to improve the labor flow from the central city to industries in the suburbs. As in other metropolitan areas, Greater Boston has been experiencing its highest rate of employment growth in the suburbs. Suburban growth in the Boston area has been closely associated with the emergence of a major industrial ring along Route 128. As of December 1967, there were 729 companies on Route 128, employing 66,041 workers (a job complex almost as large as that in Bridgeport, Connecticut). The population surge to the suburbs provided the major source of labor for the rapid employment growth on Route 128.

As employment opportunities have expanded in the Greater Boston area and the unemployment rate has declined to very low levels, the companies on Route 128 have been increasingly pressed to find workers. Tightness in the labor market and a commitment to equal opportunity employment made Route 128 employers anxious to hire Roxbury workers to fill their employment needs.

[3]The General Neighborhood Renewal Plan, Project No. Mass. R-50 discusses a proposal for industrial development of the Lower Roxbury area.

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A significant problem seemed to be the lack of public transportation facilities between Boston and Route 128. During early 1968, several conferences were held between Roxbury community groups, the Massachusetts Bay Transportation Authority (MBTA), Route 128 firms, the Waltham Chamber of Commerce and Job Opportunities in Needham. The meetings resulted in a joint program: Route 128 firms were to provide jobs, the MBTA was to run regularly scheduled buses from Roxbury to the different industrial parks, and the Urban League would act as liaison with the Roxbury community and recruit workers. The desire to get the program started by the summer led to the decision not to wait until the MBTA could obtain Federal aid. Instead, the MBTA agreed to finance the expected $60,000 deficit itself. (The deficit was estimated on the assumption of capacity use of the buses.)

The "Employment Express" was the first service of its kind in the United States. The original plan called for four buses to make round trips from Dudley Station in Roxbury to the industrial parks along Route 128. Passengers would pay 50 cents each way for the trip. Map II and Table II show the two routes used by the buses and their stops on Route 128.

Table II

Employment Express Stops on Route 128

Northbound
- Polaroid
- Waltham Industrial Parks Complex (3 stops)
- Raytheon-Burlington
- Northeast Industrial Parks Complex (2 stops)
- Burlington Mall

Southbound
- Muzi Motors (Needham)
- New England Industrial Center (2 stops)
- Westwood Industrial Parks Complex (2 stops)
- Allied Container Corporation

The original time schedule provided for buses to leave Dudley Station at 7 and 7:30 a.m. with return trips scheduled to leave Route 128 at 4:20 and 4:50 p.m. Trip time to the last stop was estimated at 1 hour and 15 minutes.

While the MBTA's commitment was only to run the buses for one year, the program was announced as a permanent addition to the transportation network. The idea was to establish awareness in the Roxbury community of a new transportation link, one that could be depended on. Since a new alternative takes time to become part of people's thinking, a sense of its permanence was felt to be important.

The "Employment Express" was inaugurated with great hopes and much fanfare on June 24, 1968. The Mayor, television cameras, and newspaper reporters were all there to launch the first busloads of workers. The previous week, the *Baystate Banner*, a Roxbury weekly newspaper, had run a special supplement about "Jobs in the Suburbs." Pages of advertising announced the availability of jobs for unskilled workers at prestigious electronics companies. The *Boston Globe*'s editorial declared: "It is hoped that by Labor Day 1,000 Roxbury job holders will be using the buses." The Saturday before the first Monday bus was to leave, a Job Day was held at the Urban League in Roxbury. Representatives of the Route 128 firms were on hand to interview and hire.

On Monday 68 people arrived to take the bus; two-thirds of them were students hired for summer jobs. By December only 60 passengers were riding on all four buses, with virtually all of them on the buses heading to Waltham.

One explanation often given for the small number of bus riders is that many persons who initially obtained their jobs by riding the Employment Express joined car pools or bought a car soon after they started work. If this is so,

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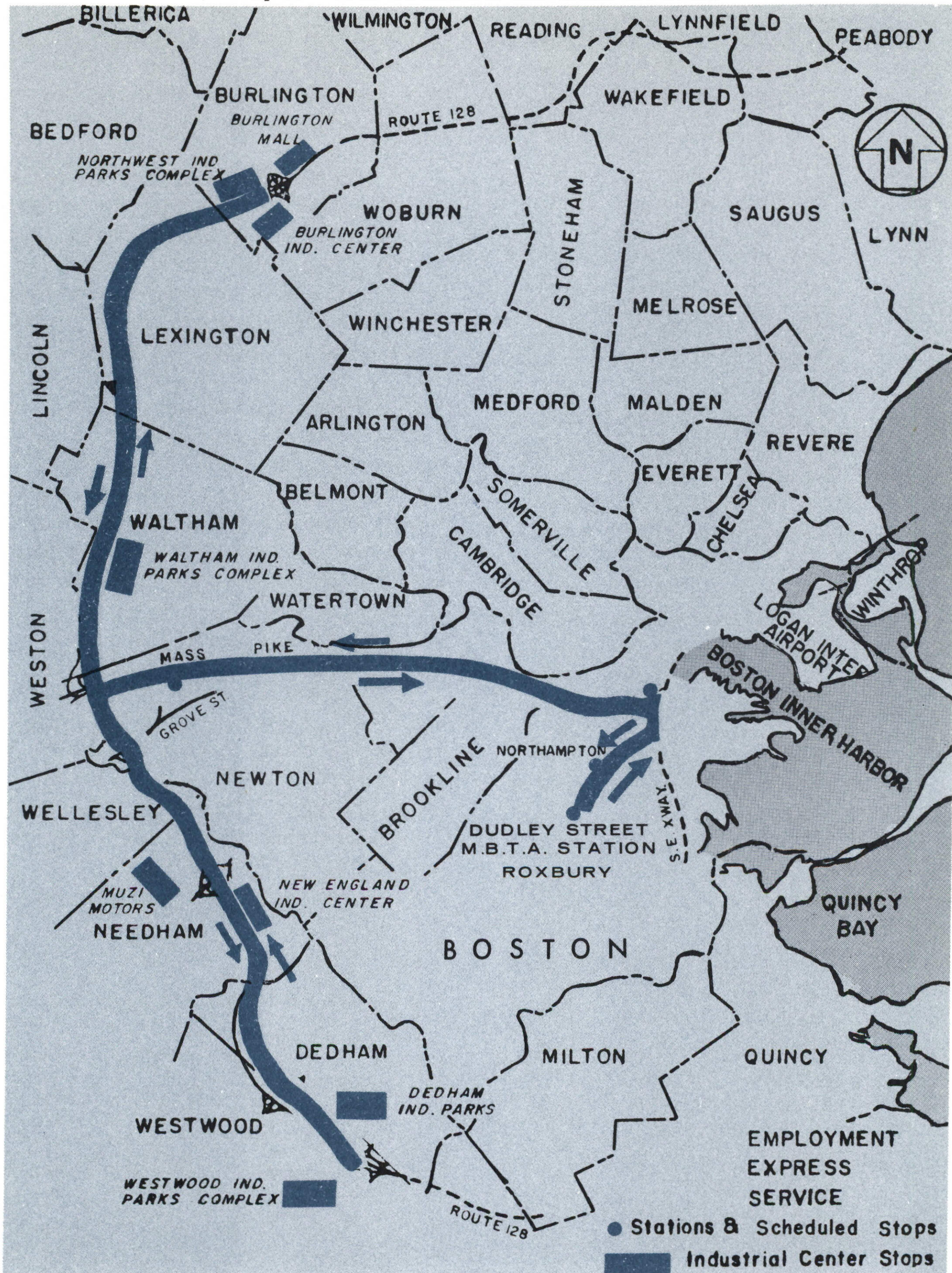
Map II — EMPLOYMENT EXPRESS ROUTES



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then the number of people on the bus at any one point in time is a very poor indicator of how many people have bettered their economic position because of the buses' existence.

To determine how many people used the bus as their initial means of getting to a new job on Route 128, the Federal Reserve Bank of Boston contacted 84 firms which employ 73 percent of the people working on Route 128. The Bank was seeking to learn how many people employed on Route 128 could attribute their jobs to the transportation link made by the MBTA bus program.

The survey indicated that 89 persons used the Employment Express as their initial means of getting to new jobs. Of these, 67 are still working at Route 128 firms. In addition, 44 students used the bus as their means of transport to summer jobs. The availability of MBTA buses to Route 128 increased only marginally the number of Roxbury workers already employed at Route 128 firms. The companies surveyed reported that they employed 1,255 Roxbury residents.

Since the survey was not a complete accounting, persons may have been hired by firms not included in the survey. The Bank's survey covered all of the firms on Route 128 employing 250 or more persons. We assumed that the larger firms have the most openings, especially for persons needing training in skills. In addition, however, we contacted smaller companies which had either sent representatives to meetings setting up the bus program or which had expressed interest in the program by contacting the Urban League or by signing petitions asking for the bus service to be continued. One way of estimating from our sample data how many persons obtained employment at all the firms on Route 128 would be to use a straight proportional projection. If it is assumed that companies not contacted hired the same proportion of people through the busing program as did the surveyed companies, then we estimate 122 persons found jobs because of the MBTA program, of which 92 are still working at these jobs.[4]

The actual number of persons using the MBTA buses as their initial link with permanent employment on Route 128 is probably somewhat less than this. It is rather unlikely that small firms could hire or would attract the same proportion of workers as the larger, better known firms.[5]

The Bank's survey does substantiate the view that many persons who intially used the MBTA buses have subsequently bought cars or joined car pools. Of the 89 persons found in our survey initially using the bus, 67 are still working on Route 128 but only 45 of them are still riding the bus. This means that a third of the people transferred to cars as their primary means of transportation to work. The survey showed that the buses are also being used by persons who already had jobs on Route 128. The firms contacted indicated that about 18 of their employees found it convenient to use the bus. The Bank's

[4]The figure used for total employment on Route 128 was 73,000. The Massachusetts Department of Commerce and Development surveys the number of firms and employees on Route 128 every 2 years. The last survey in 1967 indicated 66,041 persons were employed on Route 128. Since our survey was taken a year later, we are using for our ratio a figure for total employment 10.6 percent larger. This was the average annual growth in employment in the period 1965-1967.

[5]Another method of testing the reliability of our sample estimate of the number of new employees using the bus to obtain permanent employment on Route 128 is to do a statistical test showing the likelihood of obtaining our sample results if the actual number of persons working at Route 128 firms were much larger. Using a significance level of 5 percent, the binomial test was used to determine the largest number of persons who could be employed on Route 128, given our sample results. The binomial test indicated that there was 95 percent certainty that the actual number of new employees now working at Route 128 firms who used the Employment Express was less than 112. While our sample was not random, the bias introduced is most likely to result in too high an estimate.

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survey was thus able to account for virtually all of the 60 to 65 people riding the buses.

The bus program has not yet shown itself to be a means of opening extensive job opportunities for Roxbury residents. Several reasons can be given to explain this result, but further research would be needed to determine the appropriate weight to be given to each.

One limitation to the effectiveness of the bus program is that the bus schedules do not coincide well with plant shift times. Starting and quitting times at Route 128 plants vary substantially. For many workers, taking the bus would mean always arriving late to work. Even if supervisors were instructed to ignore lateness due to the bus, it would still present an uncomfortable situation for a new employee.

In September, the bus schedules were changed to conform better to the dispersion of plant hours. Buses were scheduled to leave for the northern route at 6:20, 6:50, and 7:20 a.m. and return from Route 128 in the evening at 3:40, 4:05, 4:35, and 5:05 p.m. The bus schedules on the southern route were also changed so that buses left Roxbury at 6:00 and 7:20 a.m. and started out from Route 128 at 3:35 and 5:00. At the same time that the times were changed, the route was altered by adding additional stops in Boston so that the bus could attract passengers from Cambridge.

The time changes, however, only partially helped the situation. Overtime opportunities are abundant at Route 128 firms and are certainly one attraction to working there. However, if a bus rider were to take advantage of overtime work, he would miss the evening bus. There is little the MBTA can do about this as long as so few people ride the buses. It cannot be expected to run buses at many different times during the evening to provide for the contingency that someone is working late that night, at least not until it can reasonably expect many people to be waiting for the bus.

While the variation in shift times is partly the result of the efforts of some firms to ease the flow of traffic in and out of the industrial parks, other firms have just arbitrarily set their shift times. Coordination among the firms in setting more uniform times, taking into account traffic problems, would certainly increase the convenience and usefulness of the bus program.

Another problem of scheduling occurs because many of the plants have revolving shifts. Workers at these plants must do time on the night and swing shifts. When workers are transferred to these shifts, the bus becomes useless for them because it is scheduled for the day shift. In plants not using rotating shifts, the most numerous openings are available on the night shift. Again, as long as so few people use the buses, the MBTA would have to provide an enormous subsidy if it were to make buses available for all shifts. It would, however, probably be useful to experiment with buses scheduled for the night shift when openings are most numerous and most difficult to fill. Since more coordinated scheduling of buses with plant shift times, especially to accommodate the night shift, appears to be a major handicap to the success of the bus program, it would seem that the MBTA should be expanding rather than curtailing the buses' operations.

The size of the present deficit should not be the limiting factor in continuing this experiment. The U. S. Department of Transportation has announced that it will pay 90 percent of the cost of a bus program between poverty areas and employment sites. The MBTA's failure to apply for a Federal subsidy last spring because of a desire to get the program started quickly is understandable, but it is not reasonable to discontinue the bus program when other funds appear available. To assure adequate funding,

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the MBTA planned to apply for Federal aid in January.

Even with a Federal subsidy, the costs of the bus program must be measured against the resulting benefits. On a marginal cost basis, revenue covers about 30 percent of the costs of the Employment Express. There is a sharp difference between the routes in the percentage of costs covered, with revenue from the northern route amounting to 45 percent of costs compared to revenue from the southern route which amounts to only 10 percent. While the revenue/cost ratio for the northern route is similar to that on a number of other MBTA routes, the low ratio on the southern route seems to indicate an inefficient allocation of public resources.

Another drawback to the bus service is that the ride is too long to attract many people. Workers in Greater Boston, and particularly Roxbury residents, are not accustomed to commuting an hour to an hour and a half each way to work. (In addition to the bus trip, the workers spend time travelling to and from Dudley Station.) The earlier experience of plants which relocated on Route 128 was that their workers either moved to the suburbs or found other jobs; rarely did they continue to make a considerably longer trip. Past experience would seem to indicate that to tap a large labor supply of low skilled workers, the companies will have to provide their employees with housing in their surrounding communities.

Trip time could also be shortened by using buses which are equipped to run at higher speeds. Instead of leasing or buying new higher speed buses (like the ones used on the Newton-Watertown line), the MBTA simply transferred city street buses to the Route 128 service. Although these buses are run at their maximum speed, they are still considerably slower than other vehicles on Route 128. Moreover, driving the buses beyond the speed at which they were designed to travel increases depreciation charges and, consequently, the cost of the bus service to the MBTA.

Another reason the bus program has not been more successful in attracting new workers to Route 128 is that wages there are not appreciably higher than could be obtained by working in Boston. The firms in the Bank survey were offering new entrants an average wage of $2.20 an hour. While this may be somewhat higher than the pay for comparable jobs in Boston, it is not enough to compensate for the longer trip.

The expectations raised by the MBTA bus program were out of proportion to what it could reasonably have been expected to accomplish. Realistically, Roxbury is not Watts; while it is a low income area, it is not isolated by a lack of public transportation to jobs. Roxbury is well served by bus and subway lines to downtown Boston and Cambridge. The Employment Express was only an additional transportation link to another employment center.

The MBTA bus was expected to be the answer to hardcore unemployment in Roxbury. Lack of transportation may be one reason why the hardcore unemployed do not have jobs, but it is certainly not the prime reason. A man who is unemployed, despite the tight labor market prevailing in Greater Boston, has more barriers to employment than lack of transportation. Unemployment in Roxbury is "primarily a story of inferior education, no skills, police and garnishment records, discrimination, unnecessarily rigid hiring practices, hopelessness."[6] Only a few of the bus riders could be characterized as having been hardcore unemployed. Most of the riders have had previous employment experience and are at least semi-skilled.

One possible explanation of why unemployed Roxbury residents did not obtain jobs on Route

[6] "Sub-Employment in the Slums of Boston," a survey by the U. S. Department of Labor.

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128 is that few openings are available for persons without skills, experience or a high school education. The BLS survey of the Roxbury-South End area in 1966 provides a profile of the unemployed and sub-employed which shows that typically males in these categories have had inadequate education and training. Two-thirds of the unemployed had not graduated from high school, and one-third of these had not gone beyond eighth grade. In addition, unemployment was found to be heavily concentrated among the 16-19 year old age group. It is doubtful that many openings for people with these educational handicaps are available at Route 128 firms.

The conclusion that transportation is only part of the problem for the unemployed is supported by the results of a similar bus program started last July in Baltimore. On 17 scheduled bus runs between the inner city and suburban employment centers, the Baltimore buses carry a daily average of 200 riders. Like the Boston buses, trip time runs about 45 minutes and the average fare is about 50 cents. The Baltimore program, which is also running a deficit, is operating under a grant from the Department of Transportation.

While bus programs do not seem to provide the solution to hardcore unemployment, it can rather safely be guessed that no one program will. Each program can be expected, however, to have some small impact on changing the conditions that generate the hardcore unemployed.

The bus riders can roughly be divided into two groups. The majority of Negroes riding the buses are young men and women who possess some skills. The bus program appears to have helped some of them get better paying jobs with greater opportunities for advancement. About a quarter of the riders are whites who use the bus for convenience.

Recruitment efforts may have been as important in obtaining jobs on Route 128 for Roxbury residents as the bus program. The Job Day organized by the Urban League last June brought to Roxbury personnel recruiters who had the power to hire on the spot. The survey conducted by the Federal Reserve Bank of Boston indicates that approximately 49 persons were hired that day and that contacts made resulted in an additional 179 persons being hired.[7] The success of the Job Day seems to demonstrate the effectiveness of hiring directly in Roxbury. Having Route 128 personnel representatives stationed in Roxbury who could interview, check references, give medical examinations and hire would be a fruitful complement to the bus program. Job recruitment and hiring centers of this type have been opened by the Ford Motor Company in low income areas in Detroit.

These personnel representatives could work at recruiting stations like Jobs Clearing House, which is financially supported by businesses in Greater Boston, and at Action for Boston Community Development, a Government supported program, both of which have done an admirable job as liaison between employers and workers in the urban core. These organizations are supplied with a list of job openings by companies in Metropolitan Boston and through their contacts in the Roxbury community recruit applicants and arrange employment interviews.

The aim of bringing industry to the central city and of running buses to suburban industrial plants is to expand employment opportunities for the urban poor. Both these programs have some potential for attaining this goal, but neither can be expected to have more than a

[7]At the Job Day, Route 128 recruiters learned of the Spanish Action Center, through which two companies hired 176 Puerto Ricans from Roxbury and the South End. Since the MBTA buses do not serve these plants, the companies leased their own buses to transport the workers.

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marginal impact on eliminating poverty. Both programs share the difficulties of reaching the hardcore unemployed and attracting them to the jobs being provided. These programs will not revolutionize the economic conditions of the Roxbury community. It should not be expected that complex problems will disappear by adding one or two programs. Many programs are needed, each approaching the problem from different aspects and each contributing only a little and slowly. It will be necessary, however, to measure contributions against costs. The need for varied programs should not override the requirement of demonstrable results.

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Remarks of Frank E. Morris, *President*
of the Federal Reserve Bank of Boston
at the Twenty-third Annual Reunion
The Stonier Graduate School of Banking — New England Group
Parker House, Boston, Massachusetts
January 30, 1969

Pax Americana and the U. S. Balance of Payments

During the past 19 years, the United States has had a balance of payments surplus, measured on the liquidity basis, in only two years — 1957 and, according to preliminary estimates, 1968. The 1957 surplus, which amounted to only $578 million, was the fortuitous consequence of the Suez War and the disruption to world trading patterns which it produced. It appears that we had a small surplus in 1968, a surplus produced by the effectiveness of our control programs on capital exports. In the remaining 17 years out of the past 19, this country showed a deficit in its international accounts.

The Reason for the 1968 Surplus

It is ironic that 1968 should be the year in which the United States produced a balance of payments surplus. 1968 was a year in which our merchandise trade surplus almost withered away. While the final figures are not yet in, it seems probable that we had the smallest merchandise trade surplus since World War II. 1968 was also a year in which the balance of payments costs of our military programs abroad rose to more than $4.5 billion. It was a year in which we had both the lowest unemployment rate since 1953 and the most rapid advance in price levels since 1951. These are not the sort of characteristics which one would normally associate with an economy breaking into surplus for the first time in many years.

All told, 1968 was a most improbable year for us to run a balance of payments surplus. There is nothing in any economic textbook which would suggest that this would happen. There are two reasons why it did happen: first, the great success of the control programs on direct foreign investment and banking lending abroad, and second, the unprecedented flow of European capital into U. S. equities.

In recent months, I have often heard the control program on direct foreign investment described as self-defeating. If I were a businessman struggling to keep a growing international operation flourishing in the face of these capital controls, I would certainly be inclined to call the program a lot of names too; but in the face of the facts at hand, I do not think the program could be called self-defeating in terms of its near-term balance of payments impact. The program was a very considerable success in 1968.

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We have detailed figures on capital movements only for the first three quarters of 1968. They show that during the first nine months of the year, American corporations sold $1.6 billion of new securities in foreign markets to finance foreign investments. In addition, they borrowed $700 million abroad and American banks reduced their loans to foreigners by $300 million. The full year figures are likely to be even larger. The capital controls, which produced these results, made the difference between another sizeable deficit and the small surplus which we actually recorded — a surplus which has kept the U. S. dollar strong in the foreign exchange markets during a very turbulent year.

Why Has the United States Been a Chronic Deficit Country?

Rather than concentrate on the near-term balance of payments situation, I would like to focus on a more fundamental question — why is it that the United States has been a chronic deficit country in its international accounts? Certainly any country which can show only two surpluses since 1949 would seem to be in chronic deficit, and without the capital controls program there would have been only one surplus year since 1949.

I would like to explore with you the reasons for the paradox that the nation which is generally regarded throughout the world as having the strongest, most progressive and technologically advanced economy should be a chronic deficit nation in its balance of payments accounts.

That the U. S. economy is generally regarded as the strongest economy in the world can be documented in many ways. Perhaps the most impressive documentation is the unprecedented inflow of foreign capital into our securities markets this year — $1.2 billion during the first nine months of 1968. In part, this inflow is a tribute to the breadth and efficiency of our securities markets as well as to a basic confidence in the U. S. economy. A world fleeing from currencies and searching for equity investments can find only two broad and highly organized securities markets in which to invest — the markets of the United States and Great Britain. But the British have not enjoyed any similar inflow of foreign capital into their markets. They have not because world confidence in the British economy is at a low ebb.

The European financial press provides daily manifestations of the basic confidence which exists in Europe with respect to the U. S. economy. Their press is filled with articles about the technological gap in favor of the United States (most of which conclude that Europe will never eliminate the gap), stories about the brain drain of young scientific talent from Europe to the United States, and articles about the vast superiority of American management and organization.

How can it be that an economy which is viewed with this degree of respect around the world should be the economy of a chronic deficit country? The answer, I believe, is not complex: the U. S. economy, as such, has not been a deficit economy in its international accounts, it is simply that the private U. S. economy has not been able to generate sufficiently large surpluses since 1949 to finance the foreign exchange costs of the enormous military and aid programs of the United States Government around the world.

Our International Accounts: Private and Governmental

I would like to quote a few numbers to you which I think may illustrate this point. Our Research Department has attempted to split the U. S. balance of payments accounts into two segments: the payments and receipts produced by the actions of the private economy, on the

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A FIRST APPROXIMATION TO THE INTERNATIONAL TRANSACTIONS OF THE U. S. PRIVATE AND GOVERNMENT SECTORS, 1960-67

(in millions of dollars)

Credits (+); debits (−)	*Total*			*Annual Average*		
	Private[1]	*U. S. Government*	*All transactions*	*Private*[1]	*U. S. Government*	*All transactions*
Exports of goods and services (including military sales contracts and grants)	**246,531**	**48,574**	**295,105**	**30,816**	**6,072**	**36,888**
Merchandise	170,807	39,388	210,195	21,351	4,924	26,274
Income on U. S. investments abroad	36,869	3,880	40,749	4,609	485	5,094
Other U. S. services	38,855	5,306	44,161	4,857	663	5,520
Imports of goods and services	**−205,058**	**−33,464**	**−238,522**	**−25,632**	**−4,183**	**−29,815**
Merchandise (excluding military)	−155,195	—	−155,195	−19,399	—	−19,399
Military expenditures	—	−26,047	−26,047	—	−3,256	−3,256
Income on foreign investments in U. S.	−8,619	−3,438	−12,057	−1,077	−430	−1,507
Other foreign services	−41,244	−3,979	−45,223	−5,156	−497	−5,653
Balance on goods and services (including military)	41,473	15,110	56,583	5,184	1,889	7,073
Unilateral transfers, net (including military grants)	−4,893	−28,377	−33,270	−612	−3,547	−4,159
U. S. capital, net; outflow (−)	**−36,116**	**−11,969**	**−48,085**	**−4,515**	**−1,496**	**−6,011**
Long-term	−28,854	−10,377	−39,231	−3,607	−1,297	−4,904
Short-term	−7,262	−1,592	−8,854	−908	−199	−1,107
Foreign capital, net; inflow (+)	**6,910**	**2,552**	**9,462**	**864**	**319**	**1,183**
Long-term	6,104	585	6,599	752	73	825
Selected short-term	896	1,967	2,863	112	246	358
Balance on capital transactions	−29,206	−9,417	−38,623	−3,651	−1,177	−4,828
Errors and omissions	−4,897	—	−4,897	−612	—	−612
Balance on liquidity basis	2,477	−22,684	−20,207	310	−2,836	−2,526

[1]Includes state and local governments, which are not separately identified in published statistics.

Source: *Survey of Current Business*, June, 1968, pp. 28-29, 39.

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A FIRST APPROXIMATION TO THE INTERNATIONAL TRANSACTIONS OF THE U. S. PRIVATE AND GOVERNMENT SECTORS, 1950-67

(in millions of dollars)

Credits (+); debits (−)	Total			Annual Average		
	Private[1]	U. S. Government	All transactions	Private[1]	U. S. Government	All transactions
Exports of goods and services (including military sales contracts and grants)	**442,661**	**78,041**	**520,702**	**24,592**	**4,336**	**28,928**
Merchandise	317,054	65,012	382,066	17,614	3,611	21,226
Income on U. S. investments abroad	57,756	6,244	64,000	3,209	347	3,556
Other U. S. services	67,851	6,785	74,636	3,770	377	4,146
Imports of goods and services	**−354,315**	**−61,944**	**−416,259**	**−19,684**	**−3,441**	**−23,126**
Merchandise (excluding military)	−273,571	—	−273,571	−15,198	—	−15,198
Military expenditures	—	−50,812	−50,812	—	−2,823	−2,823
Income on foreign investments in U. S.	−12,741	−4,594	−17,335	−708	−255	−963
Other foreign services	−68,003	−6,538	−74,541	−3,778	−363	−4,141
Balance on goods and services (including military)	88,346	16,097	104,443	4,908	894	5,802
Unilateral transfers, net (including military grants)	−9,949	−74,132	−84,081	−552	−4,118	−4,671
U. S. capital, net; outflow (−)	**−54,808**	**−16,047**	**−70,855**	**−3,045**	**−892**	**−3,936**
Long-term	−45,360	−12,091	−57,451	−2,520	−672	−3,192
Short-term	−9,448	−3,956	−13,404	−525	−220	−745
Foreign capital, net; inflow (+)	**10,286**	**2,723**	**13,009**	**571**	**151**	**723**
Long-term	9,119	585	9,704	507	33	539
Selected short-term	1,167	2,138	3,305	65	119	184
Balance on capital transactions	−44,522	−13,324	−57,846	−2,473	−740	−3,214
Errors and omissions	−23	—	−23	−1	—	−1
Balance on liquidity basis	33,852	−71,359	−37,507	1,881	−3,964	−2,084

[1]Includes state and local governments, which are not separately identified in published statistics.
Note: Data are not available on exports financed by government spending prior to 1960, except for military.

Source: *Survey of Current Business*, June, 1968, pp. 28-29, 39.

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one hand, and the payments and receipts produced by the actions of the U. S. Government, on the other. This sort of split is not easily accomplished; since the balance of payments accounting was not designed for this purpose. Therefore, cases did arise in which the proper classification was in doubt. In such cases, the benefit of the doubt was given to the U. S. Government accounts.

The resulting figures show that, during the 18-year span from 1950 through 1967, the private U. S. economy had a balance of payments surplus in 14 years and a deficit in only four years. The four deficit years were 1960, 1962, 1963, and 1964. For the 18-year period as a whole, the balance of payments surplus of the private sector was enormous, amounting to almost $34 billion. This private surplus was much more than offset, however, by a staggering U. S. Government balance of payments deficit of more than $71 billion, resulting in an over-all balance of payments deficit for the country during those 18 years of more than $37 billion. In financing this 18-year deficit, our gold stock declined by more than $12 billion and liquid liabilities to foreigners rose by more than $26 billion.

Perhaps these figures will take on more meaning to you if, instead of talking about the aggregate figures for the 18 years, we discuss what an average year during this period looked like. In the private balance of payments accounts, an average year in the 1950-67 period would show the following: a surplus on goods and services of $4.9 billion, against which we charged a net outflow of capital and grants of $3 billion, producing an over-all private balance of payments surplus of about $1.9 billion per year. Looking at the U. S. Government accounts in the average year during the 1950-67 period, we find the balance of payments costs of military spending abroad averaging $2.8 billion, with an additional $5 billion outflow in grants and loans. Even with some considerable offsets credited against these expenditures, the U. S. Government balance of payments deficit, according to our figures, netted out at about $4 billion in the average year. Deducting the average private surplus of $1.9 billion from the average U. S. Government deficit of $4 billion results in an average annual over-all balance of payments deficit for the country during this period of $2.1 billion. In financing the $2.1 billion average deficit, our gold stock declined by almost $700 million per year and liquid liabilities to foreigners rose by about $1.5 billion per year.

The 1960-67 Experience

If we look only at the most recent eight years, 1960 through 1967, we find a similar pattern. The private sector produced an average annual balance of payments surplus of about $300 million, the smaller surplus reflecting the much higher level of private investment abroad during this period. The Federal Government sector showed an average balance of payments deficit of $2.8 billion, the smaller government deficit reflecting the strenous efforts to offset partially the impact of our military and aid programs. Nevertheless, although the composition of accounts changed somewhat, the average deficit of the 1960-67 period was roughly the same size as the average for the longer period — $2.5 billion per year.

Why Have the Deficits Persisted?

In reviewing these statistics, a number of questions naturally arise. Perhaps the most basic question is this: why have we persisted, year in and year out, in pursuing a set of foreign policies which has made it impossible for our country to attain balance of payments equilibrium — a fact which has frequently had the perverse effect of reducing the influence that the United States could bring to bear in foreign affairs? The an-

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swer to this question cannot be a simple one, but I believe that part of the answer lies in the fact that, when most of these policies were originally established in the early postwar years, we had a set of economic conditions in the world which made these policies temporarily supportable.

During the years immediately following World War II, the economies of Europe and Japan were weak and disorganized. There was, as a consequence, a virtually unlimited demand for U. S. goods for a few years. The only real constraints on our exports during these years were the availability of dollars abroad and the capacity of American industry to supply foreign demand and still meet the needs of a booming domestic economy. In 1947, for example, the United States had a merchandise trade surplus of $10 billion. If this figure were adjusted only to reflect price changes, it would be equivalent to a 1968 merchandise trade surplus of $13 billion. I think it is safe to say that if we had a $13 billion trade surplus now, we could easily afford to remove our capital controls and to sustain the current level of the U. S. Government programs abroad, Vietnam War and all.

It was back in this early postwar era, a time when it was thought that there would always be a chronic shortage of dollars, that the present framework of our international commitments was formulated. Since then the structure of the world economy has changed enormously. Western Europe and Japan have long since recovered and have developed strong, dynamic, highly competitive economies. There is no longer an unlimited demand for U. S. goods. We can no longer assume, as we once could, that any dollar cast adrift in Europe or Asia will come home in the form of a demand for U. S. goods. Since 1949, $37 billion of these dollars have either stayed abroad or have been exchanged for our gold rather than our goods. Unfortunately, this dramatic change in the world economy and, along with it, the change in our ability as a nation to finance governmental commitments abroad, has not yet been reflected in commensurate changes in our foreign policies.

A Case in Point: NATO

To take one concrete example, let us look at NATO policy, which is embodied in a treaty signed in April 1949. Every year our military establishment in Europe incurs foreign exchange costs to the United States of about $1.5 billion. The figure for fiscal 1968 is estimated at $1.6 billion by the Defense Departmnet. Ours is not an occupying army living off the land. Our military establishment in Europe is fed and sheltered by U. S. dollars. I am not arguing that NATO is obsolete; the recent Russian invasion of Czechoslovakia has made it clear that an American military presence in Europe is still needed; but I am arguing that a way must be found to reduce substantially the foreign exchange burden of our NATO operations on the United States. The foreign exchange costs of NATO have amounted to two-thirds of our aggregate balance of payments deficit since 1960.

I am no military expert or geo-politician, but I am certain of one thing: if NATO were being set up from scratch today, the United States Government would not accept the balance of payments burden of the existing system. This burden is a heritage of the day when we did not have to be concerned about the international strength of the dollar. As such, it is an anachronism.

A NATO Clearing Bank?

Our efforts to offset the NATO foreign exchange costs through bilateral negotiations have not been entirely satisfactory — to us or to our allies. A multilateral approach in finance would seem to be called for to parallel the multilateral

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defense effort. Perhaps a NATO Clearing Bank might be the answer — an international financial body designed to eliminate the foreign exchange burden of NATO by shifting balances from those nations gaining foreign exchange through NATO activities to those countries losing foreign exchange as a consequence of their role as NATO members.

The NATO treaty comes up for review in 1969. Its military mission will certainly be reappraised in the light of the changes in the world since 1949. Let us hope that the treaty review will produce a much needed reappraisal of the foreign exchange burdens imposed by NATO.

The Future of Capital Controls

To those of you who are unhappy with the control programs on direct investment and on bank lending, let me say that I sympathize with you. In economic theory the most highly developed nation of the world should be the world's banker and should be a major capital exporter. It is upside-down economics for the most highly developed nation of the world to be a net importer of capital from less highly developed nations, as was the case last year.

However, I think we must ultimately face the uncomfortable fact that there are limits to American power. This is the great lesson that we should learn from Vietnam. We had to impose a tax increase to make room in our domestic economy for the requirements of the Vietnam War. As a nation, we found that we could not have both guns and butter. Similarly, the capital controls were needed to make room in our balance of payments accounts for $4.5 billion of military spending abroad in 1968. As a nation, we have found that we could not afford to play an unlimited role both as the banker for the free world and as its military protector.

The merchandise trade surplus of the United States is now at an unusually low level. It will certainly rise in 1969 and, hopefully, in the years to follow. However, I think it is unrealistic to believe that the United States can generate a merchandise trade surplus, year in and year out, of a magnitude sufficient to finance an unlimited role as world banker and at the same time to meet the present financial requirements of the Pax Americana. I believe that we face one of three options: to scale down our governmental commitments abroad, to refinance those commitments so that our allies will assume an equitable share of the foreign exchange burden, or failing this, to resign ourselves to continuing to live for an extended period with restraints on our natural role as a world banker and capital exporter.

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