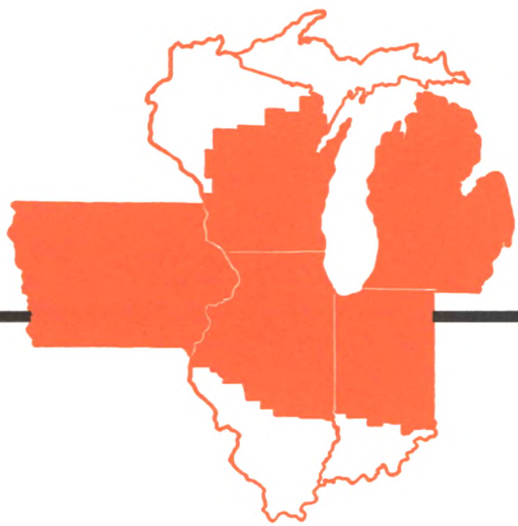
A review by the **Federal Reserve Bank of Chicago**

Business Conditions



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"Special" checking service grows more general

Of all the services that banks provide, probably the most important to the vast majority of American families is the convenience offered by the checking account. Time was when the small account was regarded as an unprofitable and burdensome business. Service charges discouraged people of modest means from keeping small balances, and many large banks turned away customers who were unwilling to maintain a minimum balance of $1,000.

The potential for more widespread use of checking account service, however, could not be ignored. Special arrangements, designed for people who write only a few checks a month and who are not in a position to tie up the amount of funds usually required as a minimum balance in regular checking accounts, have been provided by many banks. These special checking plans, which date from the well-known "checkmaster" system first offered by a small New York bank in 1935, have made it possible for the average family to have the conveniences of paying bills by mail and shopping for big ticket items without carrying substantial amounts of cash.

Not all banks offer special checking accounts and not all the plans are alike. There are a number of copyrighted systems, but most banks have developed plans to suit their own needs and facilities. Basic to all the plans, however, are the no-minimum balance feature and service charges related to the number of transactions on a more or less pay-as-you-go basis.

A survey of Seventh District commercial banks made last year provides some evidence about the availability of the special checking service in five Midwest states, differences in the methods of charging and in fees charged and other characteristics of these accounts. In general, it is apparent that a large number of bank customers use the service, that the plans and the costs differ among banks but that the behavior of these accounts is quite similar from bank to bank.

Availability and use

The survey covered a sample of 680 of the roughly 2,500 commercial banks in the District stratified by size in order to assure representative coverage. The questionnaire asked

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if the respondent offered a special checking service, and those who answered affirmatively were asked for additional information about the type of plan, method of charging and number, size and transactions volume in these accounts. Replies were received from almost 95 percent of these banks. Although not all of the respondents answered all of the questions, there were a sufficient number of answers to give reliable averages and to permit comparison of practices for banks of different sizes. More than half of the respondents had total deposits below 10 million dollars—a sample of 18 percent of all banks of that size. Of the relatively few banks with deposits in excess of 100 million dollars, more than 85 percent were included. By state, the sample coverage ranged between 22 percent of all banks for Iowa and 30 percent for Michigan.

The survey data indicate that more than 40 percent of all banks in the District offer a special checking service—about double the estimate made on the basis of the 1955 deposit ownership survey. As might be expected, special checking plans are found much more frequently among large banks than among small ones. While nearly 90 percent of the largest banks reported offering the special checking account service, only about 30 percent of the banks with total deposits of less than 10 million dollars have such plans. Among District states, availability of the service appears to be most widespread in Michigan, largely because of the greater prevalence of these plans among the small banks in that state.

It is important to note that where charges (including minimum balance requirements) on regular checking accounts are low, there is less need for a special, low-cost program. Also, at small banks, most customers are relatively small and there is less difference in net expense of providing service to small as compared with large customers. In addition, the smallest banks are generally in rural areas where the proportion of residents receiving income in the form of regular payroll checks is relatively low.

The special checking account appeals mainly to wage and salary workers who make deposits at regular intervals, keep small average balances and write a fairly constant number of checks in any given period. Urban areas have a high concentration of these individuals, and banks in these areas have a much greater incentive to offer plans that serve their needs. Rough estimates based on the survey suggest that perhaps as many as one-third of all District households have special checking accounts.

Seventh District banks offering special checking service

Bank deposit size (million dollars)	Illinois	Indiana	Iowa	Michigan	Wisconsin	Five states
	(percent of all banks)					
Under 10	35	5	29	50	32	31
10–25	84	29	91	81	67	73
25–50	87	82	77	82	58	80
50–100	88	90	100	77	100	89
Over 100	75	100	100	94	100	88
All banks	53	21	36	63	41	43

Characteristics differ

The distribution of special checking account banks in each size group according to their answers on a number of survey questions is shown in the table on page 4. Several interesting facts emerge from the data:

1. A relatively large proportion of the smaller banks have entered the field recently.

2. The smaller banks tend to make somewhat greater use of copyrighted plans, which can be purchased complete with supplies and procedures required for their operation.

3. Only in the smallest size group does the sale-of-checkbook type plan predominate.

4. The majority of the banks in all size groups offer the service to individuals only, but the service is available to churches and non-profit groups at about one-third of the banks and to small businesses at still fewer banks. (Accounts not held by individuals constitute less than 5 percent of special accounts in a large majority of the banks which offered the service to other types of users.)

5. Most of the banks in all size groups reported offering special checking accounts in order to perform a public service or to meet competition.

6. A large majority of banks in all size groups reported that their plans are profitable—adjustments of charges were contemplated by about 8 percent of the survey respondents.

How important are these special checking accounts to the banks? For those banks that offer the service, 42 percent of demand deposit customers are in the special account category. There are substantial differences between large and small banks, with the large banks showing the greatest proportionate number of special accounts (see table). Not only have the large banks built up this business over a longer period of time, but location makes their facilities convenient to greater numbers of the type of customer the special plans are designed to serve.

In terms of the dollar amounts, on the other hand, special checking balances comprise a small portion of total demand deposits—about 5 percent for the District. In dollar volume the special accounts are relatively more important at the smaller banks. This reflects the much larger average size of regular accounts at the big banks where large business firms usually have their balances. In

Percent of banks reporting certain characteristics of special checking account service

	Bank deposit size (million dollars)				
	Under 10	10–25	25–50	50–100	Over 100
	(percent of banks in each size group)				
Plan in operation					
Under 5 years	45	13	4	4	14
5–10 years	28	34	30	19	21
10–20 years	19	33	33	48	28
Over 20 years	8	20	33	29	37
Plan used					
Bank's own	66	61	69	82	79
Copyrighted	34	39	31	18	21
Method of charging					
Sale of checkbook	57	47	50	28	23
Charge per check	43	53	50	72	77
Availability					
Individuals only	70	58	56	65	67
Individuals and others	30	42	44	35	33
Reasons for offering service					
Increase income	12	18	22	21	22
Meet competition	37	39	36	34	29
Public service	48	41	41	38	45
Retain small accounts	3	—	—	3	1
Gain customers	—	2	1	4	3
Effect on profits					
Profitable	79	85	89	79	88
Not profitable	21	15	11	21	12
Contemplated changes					
None	89	87	86	89	95
Adjustment of charges	6	12	11	7	5
Switch to single all-purpose personal account	5	1	3	4	—

relation to personal deposits, however, special balances are much larger than these figures indicate.

The ratio of special to total demand deposits might be expected to be influenced by the method of charging on regular checking accounts. There is some evidence that this is true. Special deposits averaged almost 10 percent of total balances for banks that reported basing earnings credits for regular accounts on a simple minimum monthly balance, compared with 6 percent at banks permitting a free check allowance per $100 of average balance maintained.

Two ways to pay

Plans offered by different banks vary considerably in detail, but they can be classified into two general types by the manner in which service charges are made. The first is through the purchase of a book of checks—"sale-of-book" system. The second is through a charge for each check paid and, in a few cases, a charge for each deposit transaction—"charge-per-check" system. With either system there may be also a flat monthly maintenance charge, but this is much less common with the first method than with the second.

The majority of survey respondents did not charge a monthly maintenance fee

Cost per check (cents)	Maintenance charge (cents per month)					
	None	1-25	26-49	50	Over 50	Total
	(number of banks)					
Charge-per-check system						
3-5	2	6	—	1	—	9
6-8	7	—	2	1	—	10
10	94	35	6	21	1	157
11-12	6	2	—	4	—	12
Total	109	43	8	27	1	188
Sale-of-book system						
1-5	12	—	1	1	1	15
6-8	36	2	1	—	—	39
10	82	5	—	9	—	96
11-15	18	—	—	—	—	18
Total	148	7	2	10	1	168

The information submitted in the survey shows that the charge-per-check system is used by most banks and that it is particularly prevalent among the largest banks.

Of the smallest banks 57 percent were using the sale-of-book method in early 1966 (see chart). Only a few added a monthly maintenance charge. As the size of bank increases, the proportion of banks using charge-per-check plans, especially with an added maintenance charge, also increases. Nearly half of the banks with total deposits of more than 100 million dollars have charge-per-check systems combined with monthly maintenance fees. The

Special accounts at the average bank comprise large number but small dollar volume of demand deposits

Bank deposit size (million dollars)	Number of accounts: Special	Number of accounts: Regular	Number of accounts: Special to total	Amount of demand balances: Special	Amount of demand balances: Regular	Amount of demand balances: Special to total
	(thousand accounts)		(percent)	(million dollars)		(percent)
Under 10	1.0	1.8	36	.3	2.6	10
10-25	2.4	3.4	41	.6	6.7	9
25-50	4.2	5.2	45	1.1	12.8	8
50-100	5.8	8.5	41	1.6	31.4	5
Over 100	23.3	25.1	48	5.9	196.5	3
All banks	3.0	4.1	42	0.8	15.6	5

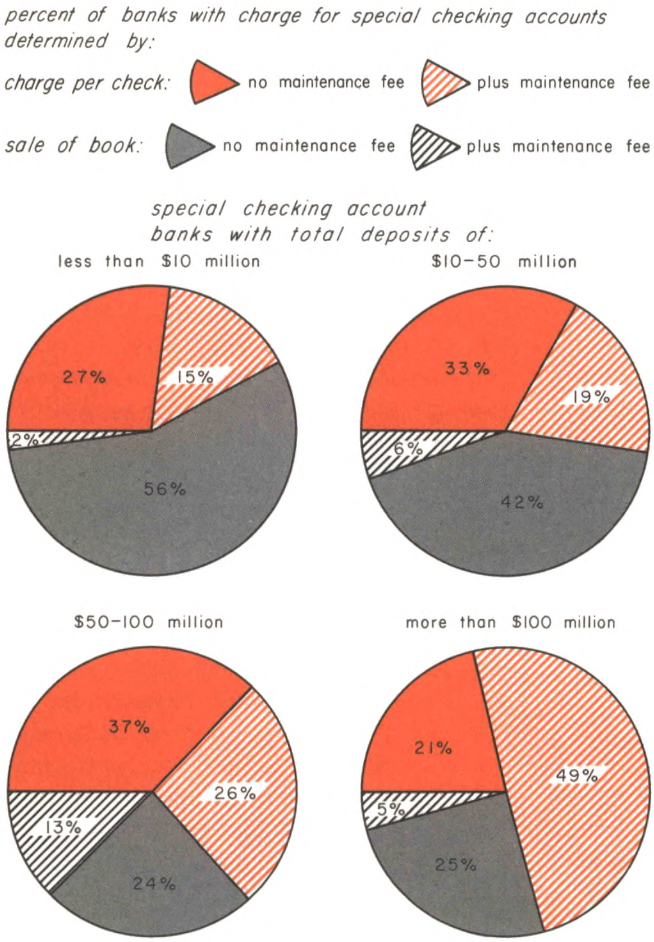
trend appears to be toward this type of system. Sixty percent of the plans established within the past five years are charge-per-check plans. Among the larger banks it appears that automation has fostered this system by making it operationally feasible and can be expected to substantially reduce its bookkeeping costs.

Within these two main methods of charging for the special checking service, there is considerable variation in the amount of such charges. While it is clear that the majority of District special checking banks charge 10 cents per check under either plan, the survey revealed a range of 1 to 15 cents per check. Maintenance fees ranged as high as a dollar a month although they were typically either 25 or 50 cents when used at all. The number of survey banks reporting various combinations of check cost and maintenance fees for both types of plans is shown in the table on page 5. This tabulation gives little indication that high maintenance fees are associated with low check costs, or vice versa.

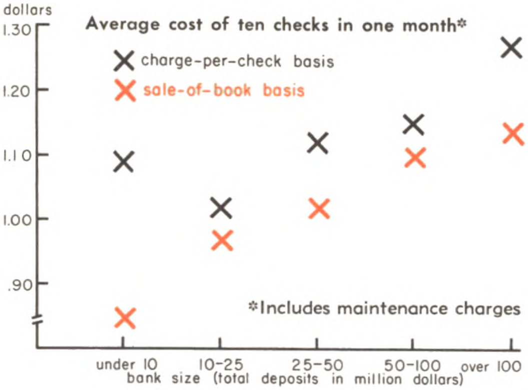
The type of charge may be related to the profitability of the checking service. Although the survey did not permit estimation of actual profits or losses on this operation, the service was reported as not profitable by a significantly larger proportion of banks using the charge-per-check system. This was true, however, only for the banks with total deposits of less than 50 million dollars.

Some evidence on the average profitability of special checking accounts is available from the functional cost analysis service provided by this Reserve Bank. For District member banks with total deposits of less than 50 million dollars that participated in the program, computed net earnings before taxes attributable to the special checking function in 1966 were 3 percent of average special checking account bal-

Method of charging for special checking service related to size of bank



Cost of service to customer varies by size of bank and type of plan



ances. Average earnings per month were 65 cents per account. For the banks with deposits between 50 and 200 million dollars, net earnings per month averaged only 23 cents per account. While the larger banks reported higher income per account both from activity charges and imputed portfolio earnings than did the smaller banks, their expenses were higher by an even larger margin. To some extent this may reflect the predominance of the higher-cost charge-per-check system within this group of banks.

Differences in various aspects of the charges are reflected, of course, in the cost to the customer. In order to compare the costs of these systems at different banks, the charge for the same service—ten checks in a one-month period, and including any applicable maintenance charges—was computed for each respondent bank. The monthly cost of this service ranged from as little as 50 cents to as much as $2. Averages by bank size groups and by type of charge system are shown in the chart.

Two facts emerge clearly from the above comparison—the overall cost to the customer rises with the size of the bank and is higher for all size groups under the charge-per-check system. The average customer of a large bank on a charge-per-check system pays almost 50 percent more to write ten checks per month than the customer who buys a checkbook at a small bank. These comparisons, of course, do not take account of differences in other services to which the special checking customer may be entitled. There is evidence that at some banks these depositors receive almost a full range of banking services.

The "average" account

From the standpoint of the bank, the value of a checking account depends on its size and its activity, for these factors determine, respectively, its earning power and the expense entailed. The special checking customer has this type of account because he does not want to keep a large balance. At the same time, he normally has a small number of transactions compared with the holder of a regular checking account.

The average special checking account balance is between $250 and $280, much smaller than the average regular account. The average size of the special accounts does not vary with size of bank while in the regular accounts the average balance rises sharply with bank size, reflecting the effects of large deposits, especially business accounts. Since the special account holder has nothing to gain from maintaining a large balance, he tends to keep it as low as his transactions requirements permit. Despite the huge growth in the aggregate of special checking account balances, the average account at District banks appears not to have changed significantly from the level estimated more than ten years ago from the deposit ownership survey data.

The average number of transactions per account is almost as stable as the size of account. For every bank size class the average special checking customer wrote nine checks a month and made two deposits. Again, as the accompanying table shows, regular accounts were much more active, especially at the large banks.[1]

Monthly account turnover—the ratio of dollar amount of debits to average balance—indicates the rate of use of the money. Despite relatively low balances, the special checking accounts show average turnover rates well below those for regular accounts, and again, these rates are quite similar for banks of all sizes.

The special checking service has developed from the need of the average citizen with modest means for a convenient type of money. Commercial banks are in a position to provide such service. At the same time, more and more people are becoming aware of the indirect costs of not having a convenient and safe means of payment. It seems likely that the more widespread use of credit cards and even the advent of the "checkless" society can only increase the public's demands for some kind of bank deposit account that can be transferred easily and safely, whether through the check process or a checkless bookkeeping entry. The special checking account has proved that banks can provide service to small depositors on a profitable basis and at low cost to these customers; it can be expected to grow and to evolve in response to ever-changing needs.

In contrast to regular checking accounts, the average special account shows little variation by size of bank in . . .

	Bank deposit size (million dollars)	Special accounts*		Regular accounts*	
		Dollars		Dollars	
. . . size of average balance per account	Under 10	267		1,394	
	10–25	246		1,956	
	25–50	270		2,497	
	50–100	279		3,674	
	Over 100	252		7,835	
		Checks paid	Deposits received	Checks paid	Deposits received
. . . number of transactions per month	Under 10	9.1	2.1	16.2	2.8
	10–25	8.8	1.8	19.2	3.1
	25–50	9.5	2.0	21.3	3.5
	50–100	9.1	1.9	23.7	3.4
	Over 100	8.7	2.0	34.4	3.8
		Percent		Percent	
. . . and rate of turnover per month	Under 10	1.37		1.56	
	10–25	1.46		1.75	
	25–50	1.66		2.16	
	50–100	1.47		2.28	
	Over 100	1.32		2.91	

*As of January 1966.

[1]The results of the special survey with respect to size of accounts and activity were confirmed by the information available through the functional cost program.

Defense activity in the Midwest

In World War II and again in the Korean War industrial plants in the Seventh Federal Reserve District, especially those of the automotive industry, played a leading role as the "arsenal of democracy." Since emphasis shifted about 1953 from conventional arms to electronics and aerospace, the relative participation in defense programs by the District states—Illinois, Indiana, Iowa, Michigan and Wisconsin—has been sharply reduced.

The requirements of the Vietnam War have reversed this downtrend but only to a moderate degree. If stable peace were to be achieved, the direct impact upon the Midwest would be much less than upon industrialized areas of the Far West, the East and the Southwest. Data recently made available by the U. S. Department of Defense (DOD) permit a more accurate evaluation of the regional concentration of defense activities than was possible in the past.

The costs of war and peace

Purchases of goods and services for national defense, including pay of the armed forces, reached an annual rate of 70 billion dollars in the first quarter of 1967. These outlays had remained at a rate of about 50 billion dollars from 1961 to mid-1965 when the decision was made to step up this nation's participation in the Vietnam War. Currently the Vietnam effort is estimated to account for more than 20 billion dollars of total defense outlays. Mainly because of these programs, defense expenditures are expected to continue to rise, at least through 1967.

About 80 percent of all direct Federal purchases of goods and services currently are for national defense, up from 75 percent two years ago. Defense outlays now account for more than 9 percent of total production of goods and services (gross national product); two years ago this ratio was 7.3 percent.

Despite the rapid increase in defense outlays, the ratio of these expenditures to total production remains below the 13 percent proportion for the Korean War or even the 10 percent for 1957 and 1958, to say nothing of the 42 percent share in World War II. The extent of any further rise in this ratio will depend upon the growth of total production as well as the rise in defense requirements.

The regional impact

National defense affects the economy in several ways. First, there is the drain of manpower into the armed forces which numbered almost 3.5 million in May—400,000 more than a year earlier. These men and women are drawn originally from all states in approximately equal proportions but their assignments, and presumably their personal expenditures, are concentrated according to their location at military bases and other defense facilities and activities. In addition, about 2.5 million civilians are working on defense contracts or are employes of the DOD. Together these groups can be termed "civilian defense employment" or, in the DOD's phrase, "defense-generated employment." (Many of the DOD workers are employed at military bases.) To a large extent the location of servicemen and civilian defense workers determines the regional distribution of defense expenditures.

The five states of the Seventh District contain about 16 percent of the nation's population and an approximately equal proportion of its labor force. But these states have less than 7 percent of civilian defense employment and only about 5 percent of the military personnel stationed in the 50 states and Washington, D. C.

Civilian defense employment and military personnel account for far smaller proportions of the work forces in each of the District states than the national average. The accompanying table shows civilian defense employment and the location of military personnel as of mid-1966. Of the 93,000 military personnel quartered in the five-state area, two-thirds were in Illinois at such installations as Fort Sheridan, Great Lakes and Chanute Field.

The highest ranking District states in total civilian defense employment is Illinois, in 14th place. Indiana, in 17th place, is next. Ranked according to the *proportion* of each state's work force in defense employment, Indiana is number 27, Illinois 38, Michigan 41, Iowa 47 and Wisconsin 48.

Combining civilian defense employment and military personnel, Illinois and Indiana have about half of the United States average "share" in proportion to the work force in these states. For Iowa, Michigan and Wisconsin this ratio is about one-fourth.

The top five states in civilian defense employment are California—with 17 percent of the total—followed by Texas, New York, Pennsylvania and Virginia, each with between 5 and 6 percent. Of these only New York and Pennsylvania have a smaller proportion of civilian defense employment than their proportion of the nation's work force.

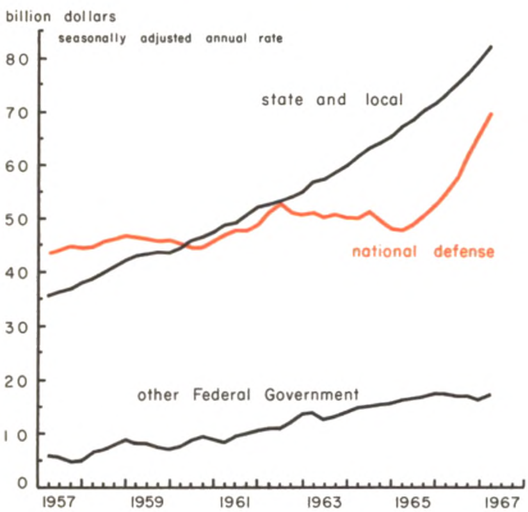
California and Texas also have large military bases. In these states civilian defense

Distribution of defense employment in June 1966

	Work force as percent of United States	Defense-generated employment*			Military personnel	
		Thousands	Percent of United States	Percent of work force	Thousands	Percent of United States
Illinois	6.0	60	2.5	1.3	60	3.3
Indiana	2.6	44	1.8	2.2	10	0.5
Iowa	1.5	10	0.4	0.8	2	0.1
Michigan	4.1	36	1.5	1.1	18	1.0
Wisconsin	2.3	15	0.6	0.8	3	0.2
Five states	16.5	165	6.8	1.3	93	5.1
United States	100.0	2,387	100.0	3.0	1,833	100.0

*Includes employment at plants producing defense goods plus civil service employment at Department of Defense installations.

National defense expenditures have outpaced other Government purchases of goods and services



employment and military personnel combined are 1.6 times the national average in proportion to the work force.

The states most heavily dependent upon defense on a relative basis are Alaska, Utah and Hawaii, followed by Washington, D. C. In each of these areas, 8 to 10 percent of the work force is in civilian defense work. In addition, except for Utah, these areas have large concentrations of military personnel.

Defense contracts concentrated

For several years the DOD has published data on military procurement by states. These figures do not purport to "provide a direct indication of the state in which the actual production is done" but indicate "the location of the plant where the product will be finally processed and assembled." Until recently it was widely believed that extensive subcontracting spread the impact of defense procurement fairly evenly throughout the nation.

Department of Defense prime contract awards

	Fiscal year		
	1965	1966	1967*
	(percent of United States)		
Top five states			
California	22.1	18.3	18.1
New York	9.6	8.9	8.9
Texas	6.2	7.2	8.9
Connecticut	5.1	6.5	5.9
Pennsylvania	4.2	5.3	4.0
Total	47.2	46.2	45.8
Seventh District			
Illinois	1.8	2.9	2.7
Indiana	2.6	3.4	2.2
Iowa	0.6	0.8	0.7
Michigan	2.3	2.9	2.5
Wisconsin	0.9	1.1	1.0
Total	8.2	11.1	9.1

*Nine months.

A recent DOD study of subcontracting indicates, surprisingly, that defense work is even *more* concentrated than suggested by prime contracts. While the top ten states account for about 65 percent of all prime contracts, the top ten states on the basis of subcontracts account for more than three-fourths of the total. The leading prime contract states are, by and large, also the leading states for subcontracts. Apparently prime contract information, published quarterly, can be taken as a rough measure of defense work actually performed in the various states.

Military procurement contracts totaled 35.7 billion dollars in fiscal 1966 (July 1965-June 1966), compared with 26.6 billion in fiscal 1965. For the first nine months of fiscal 1967 (ending in March), procurement was up about one-fourth from the comparable period a year earlier.

None of the Seventh District states receives a large volume of defense contracts relative to its total industrial capacity. The District states account for more than 22 percent of the nation's output of manufactured goods. The accompanying table shows the proportion of military procurement obtained by the top five states and the District states in recent fiscal years, based upon prime contract awards.

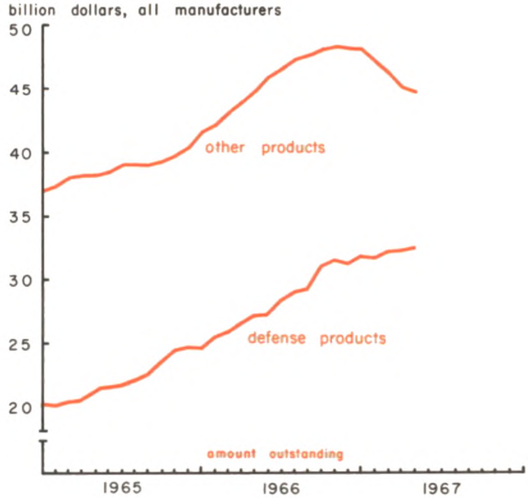
Defense contracts in the five-state area averaged somewhat less than 8 percent of the total in the early part of the Sixties. Apparently the proportion of defense requirements purchased from Illinois plants has increased with the escalation in Vietnam. No clear pattern has emerged for the other states. The dollar value of defense procurement in all five states has increased substantially since mid-1965 but not much faster than the total.

Defense contracts to come

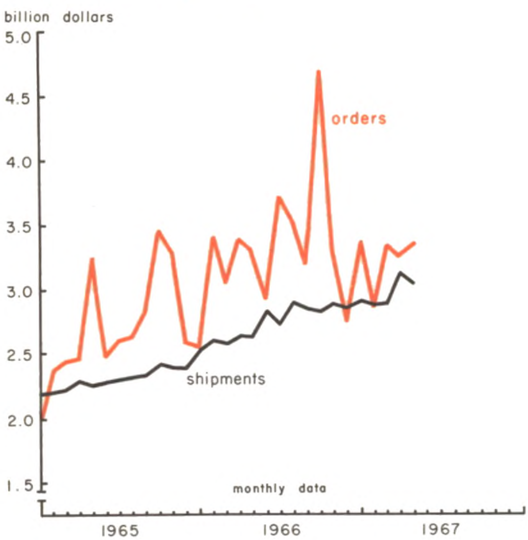
Fluctuations in defense orders have dominated movements in total manufacturers' orders at various times in the past two years. Similarly the buildup of defense work has tended to distort changes in total manufacturers' inventories, especially goods in process.

Shipments of defense products have exceeded an annual rate of 36 billion dollars in recent months, accounting for about 7 percent of all manufacturers' shipments and probably an even larger proportion of shipments of finished goods. Order backlogs of defense products totaled 32.5 billion dollars at the end of April, about 42 percent of all manufacturers' order backlogs. Although order backlogs for "defense products" are inflated somewhat by the inclusion of certain nondefense products such as commercial aircraft, it is clear that the momentum of the nation's manufacturing activity has been influenced heavily by the direct and indirect effects of defense procurement.

Order backlogs for defense products have risen further as other backlogs have declined



Manufacturers' orders for defense products continue to exceed shipments



Short of a broader land war involving United States forces, District firms are unlikely to obtain an appreciably higher proportion of defense orders in the years ahead. The dollar volume of military hardware procurement continues to be strongly concentrated in aircraft, missiles and ships, to which the principal industries of this region make only a small contribution relative to their importance in the national economy. This picture may be altered somewhat if developing margins of unused capacity encourage District firms to seek defense orders more aggressively.

Limited emphasis on defense work has a favorable aspect for the Midwest. Should international tensions relax sufficiently to permit a sizable cutback in defense expenditures, the accompanying dislocations directly attributable to this development would be relatively minor in this region.

Profile of savings deposit rates

Savings or passbook accounts tend to be very similar at all commercial banks. Deposits generally may be made on any business day and in any amount; withdrawal requests are honored on a demand basis, as the permissible 30-day notice requirement is almost never invoked. Savings accounts lack the specific maturities and the minimum denominations and fixed multiples of amounts common to other forms of time deposits. It might be expected, therefore, that individuals would shop to get the highest rates available, much as they shop for bargains on things they buy. Despite these similarities from bank to bank, rates paid on savings deposits may differ appreciably—even among banks located within the same city.[1]

Information on interest rates paid on savings deposits by member banks in the Seventh Federal Reserve District was collected early this year as part of a nationwide survey. The maximum rates permitted by applicable regulations are 4 percent for banks in Illinois, Iowa, Michigan and Wisconsin, and 3.5 percent for banks in Indiana. While there was a large grouping of banks at the ceiling rates (three-fifths of the total), the survey revealed a substantial range of rates being offered by two-fifths of the banks.[2] Rates of 2 percent or less were reported by 11 percent of the banks and 26 percent reported paying 3 percent.

Rates paid on savings deposits are summarized in the table on page 15 for the metropolitan areas and the District. In 11 of Michigan's 13 metropolitan areas the "prevailing" rate at the end of January was 4 percent. The exceptions were Jackson and Battle Creek in the south central part of the state, where rates of 3.0 and 3.5 percent prevailed. In Indiana, the Gary-Hammond area had the lowest rates, with its major banks paying either 2 or 3 percent, despite the proximity to Chicago, where 4 percent was the predominant rate. In almost all of the large cities in Illinois, the prevailing rate was 4 percent. The major exception was the Quad Cities (Davenport-Rock Island-Moline-East Moline) on the Iowa border, where 3 percent was the customary rate.

The prevailing rates varied more among Iowa and Wisconsin cities than in the three

[1]While savings deposit services provided by commercial banks may appear alike to depositors, they may not be so regarded by commercial bankers. Small accounts that have numerous in and out transactions are more costly to handle than accounts with little activity or large balances. Therefore, some banks, while paying the same rate of interest on all accounts, impose charges aimed at limiting the number of transactions, and some pay a lower rate on accounts with balances of less than, say, $1,000. However, these practices are not widespread.

[2]The data used in this article relate to the *most common rate paid*, which generally is also the highest rate, but may be lower in instances where the bank has a comparatively large minimum balance upon which the top interest rate is paid. Only 13 of the District's 992 member banks in January 1967 reported a rate lower than the highest as their most common rate. Therefore, very few banks were undertaking to relate interest yield to size of account.

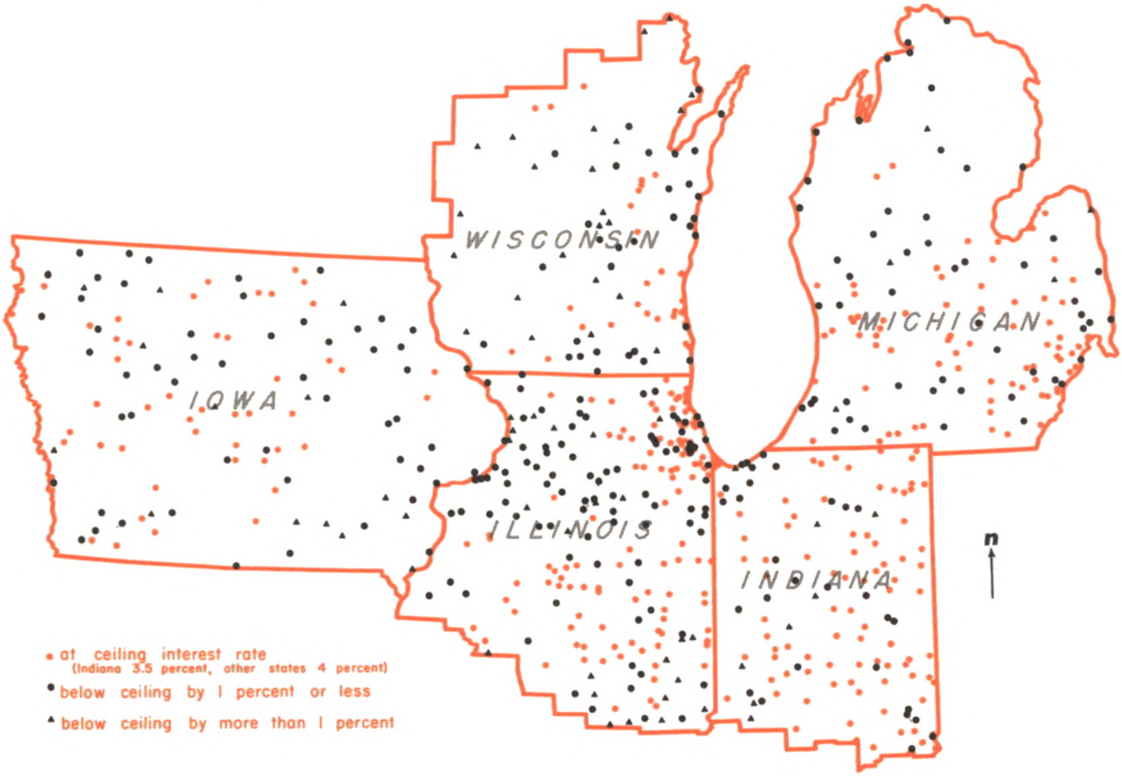
The tendency for the same rate to prevail on accounts of all sizes is evident also for banks that are not members of the Federal Reserve System. Data from the Federal Deposit Insurance Corporation's 1966 *Survey of Deposits* of insured banks show comparatively little association between proportions of large and small accounts and the rate of interest paid on savings deposits.

other District states. In both of these states, about as many centers were at 3 percent as were at higher rates. Burlington, Muscatine and Dubuque, all in eastern Iowa, had prevailing rates of 3 percent—the same as the nearby Quad Cities—but in Sioux City, in the western part of the state, 4 percent was predominant. In Wisconsin, banks in Sheboygan, Manitowoc and Green Bay reported a prevailing rate of 3 percent, compared with 4 percent in nearby Appleton and Oshkosh. Kenosha banks paid 3 percent although banks in Racine (10 miles away) were paying 4 percent.

Rates paid on savings deposits, therefore, often differ between communities quite close to one another. This rate pattern is different from that for large negotiable certificates of deposit, issued mainly to business firms and state and local governments. These large funds flow more readily among communities in response to fairly small differences in rates and, therefore, are effective in balancing supplies with demands over wide areas. Interarea uniformity in rates is greater also for the small certificates of deposit, issued primarily to individuals, than for savings deposits.

Banks that pay relatively low rates on sav-

Interest rates paid on savings deposits by Seventh District member banks, January 31, 1967



ings deposits were more often in the smaller than in the larger communities. They tended to be in one- or two-bank towns, reflecting in good part the close association between a community's size and the number of banks serving it. In the Illinois, Iowa, Michigan and Wisconsin areas, 81 percent of the banks paying less than 4 percent were in one- and two-bank towns, compared with 58 percent of the banks paying the 4 percent ceiling rate.

Nevertheless, with almost three-fifths of the banks in one- and two-bank towns paying the maximum rate permitted by regulation, it is clear that the number of banks in a locality is not the decisive factor in determining the prevailing rate. Presumably an important factor is the strength of loan demand in the area and the judgment of bank managements about the responsiveness of deposit flows to both the level of rates and changes in rates.

The characteristics of the community and its population also appear to explain some of the differences in rates. In large metropolitan areas the rates offered by banks operating in affluent suburban communities frequently were equal to those at the largest banks in the central city. This often occurred even where unit banking prevails and the big downtown banks have no branches, and where the suburban town has but one bank. In sectors of the area where the population is less knowledgeable and less mobile, rates tended to be lower.

Of the few banks in the major metropolitan areas of the District paying 1 or 2 percent for savings in January, while nonetheless experiencing considerable growth of savings deposits, almost all were located in neighborhoods where personal incomes are low. In these neighborhoods, savings accounts are used frequently instead of the less familiar checking accounts as a means of temporary

Distribution of member banks by interest rate on savings deposits, January 31, 1967

	Total member banks	Interest rate (percent per annum)* Under 2.0	2.0	3.0	3.5	4.0
				(number)		
Metropolitan areas	**476**	**6**	**11**	**93**	**57**	**309**
Illinois	233	5	3	36	20	169
Chicago	149	2	2	12	18	115
All other	84	3	1	24	2	54
Indiana	50	1	3	14	32	
Indianapolis	16			2	14	
All other	34	1	3	12	18	
Iowa	40		2	15	1	22
Des Moines	10			1		9
All other	30		2	14	1	13
Michigan	102		1	14	4	83
Detroit	35			6		29
All other	67		1	8	4	54
Wisconsin	51		2	14		35
Milwaukee	21					21
All other	30		2	14		14
Other areas	**516**	**39**	**49**	**169**	**127**	**132**
Seventh District	**992**	**45**	**60**	**262**	**184**	**441**

*A bank specifying a rate between those listed is included in the lower rate category.

safekeeping of funds needed to pay bills. This tends to cause high activity and higher servicing costs for savings deposits and could explain payment of lower rates.[3]

Lack of sufficient funds to be concerned about rates or lack of information on alternative banks would seem a key element in the failure of customers of banks paying relatively low rates to shop for a "better" price, for in some cases banks with differing rates were located only a few blocks apart. In these instances, a change in banking connection would imply little sacrifice in convenience. When distances separating banks are greater, of course, additional costs for postage or for transportation impede the shifting of funds in response to yield differences. A third of the banks in the Chicago area paying less than 4 percent were within the city limits, with two on the city's near south side—all within easy commuting distance from the highly competitive downtown financial district. Most of the others were in the western suburbs, with very few in either of the north or far south suburban towns. In the Gary-Hammond area, banks in Gary were paying 2 percent; those in Chesterton-Porter-Valparaiso, 3 percent; and those in Hammond, Whiting and East Chicago, the 3.5 percent ceiling rate. These cities are all contiguous, connected by major expressways.

Half of the the District's metropolitan areas had some diversity among interest rates paid by member banks on savings deposits. Communities served by branch banking systems appear to have less rate divergence, especially if the larger banks advertise their savings rates via radio-television or in newspapers that reach residents of the neighborhoods served by the branches. Also, smaller communities with few banks were less likely to have interbank rate differences.

Recent developments

Less than two dozen District member banks changed their rates on savings deposits in the three months after the January 1967 survey, according to preliminary tabulations of a similar survey conducted at the end of April. The few banks that raised rates between January and April were, on the whole, smaller establishments "catching up" with rates paid by their larger counterparts. Kenosha was the only metropolitan area where the prevailing rate rose, and there the banks moved from 3 to 4 percent, apparently in response to competitive pressures from banks in Milwaukee and Racine. One small city bank in the Chicago area, however, reduced its rate, as did a few others, mostly in Michigan. A smaller bank without highly publicized rate schedules is more easily able to reduce rates without causing deposit declines than is a large money center bank. Fewer banks, however, lowered than raised their rates on savings deposits between January and April, despite easier monetary conditions. Rate patterns remained essentially unaltered, with a variety of rates persisting on a basically homogeneous service.

[3]An analysis of turnover rates for the various areas (that is, withdrawals during the period divided by average balances in the period) does not suggest, however, that activity was consistently higher in the areas with the lower rates. The turnover of savings accounts over the past five years averaged lower in the smaller cities of Iowa and Wisconsin than in the Michigan communities, although the prevailing interest rate on savings was more often the ceiling rate in the latter communities. An array of the Chicago banks paying less than the maximum permissible rate according to their turnover of savings accounts in a recent year shows them to be distributed throughout the range of turnover rates.