In our dual banking system, state- and federally chartered banks currently operate in each of the 50 states. The dual banking system would be largely unaffected if interstate banking occurred through repeal of the Douglas Amendment. States would continue to regulate state-chartered interstate bank subsidiaries, and federal regulators would supervise those with federal charters. The repeal of the McFadden Act, however, to permit interstate branching would probably create some formidable problems. For example, jurisdiction over interstate branches of state-chartered banks would have to be allocated, and differences in state regulatory policies toward state-chartered banks would have to be resolved.

Conclusion
A growing number of states permit interstate banking, a trend that is pressuring federal legislators to relax interstate banking barriers. Evidence suggests that removing these barriers would encourage beneficial competition among banks. However, it is doubtful whether current antitrust laws are adequate to prevent the possible negative effects of geographically unrestricted banking. If antitrust laws were teamed with federal guidelines limiting the size of acquisitions, the adverse effects of higher concentration levels could be minimized, and consumers could benefit from the removal of interstate banking barriers.

Banking without Interstate Barriers
by Thomas M. Buynak, Gerald H. Anderson, and James J. Balazsy, Jr.

In today's deregulated banking environment, more and more states are considering loosening their interstate banking restrictions. Ohio, Michigan, and Florida are three of about fifteen states currently considering interstate banking legislation. If such legislation were enacted, these states would join 15 other states that already allow some form of interstate banking. Most of the interstate banking laws are very restrictive as to who can enter and the powers of the entrants. States with the least restrictive laws include Alaska and Maine, which allow interstate banking with any state; New York, which allows interstate banking with any state that permits reciprocal entry; and Massachusetts, Connecticut, and Rhode Island, which allow banks from reciprocating states in New England to expand interstate and bar banks from entering from outside the region.1

According to interstate banking opponents, removing barriers to interstate banking might bring on the consolidation of the banking industry into a few large banks. An example of such concentration is Canada's banking structure, in which there are only 11 banks, each controlling on average about $25 billion in assets. However, advocates of interstate banking contend that geographic banking restrictions are anachronistic in today's financial environment. Interstate banking barriers are being rendered ineffective by technological advances such as electronic funds transfer. Banks are also placed at a disadvantage as they increasingly compete with nonbanking firms, such as Merrill Lynch, Prudential-Bache, and Sears, that market financial services through nationwide networks.

De facto Interstate Banking
Despite legal restraints on interstate banking, banking organizations and their subsidiaries have established extensive interstate networks in the past 10 years. In fact, except for taking in retail deposits, some banks perform virtually all of their banking functions on an interstate basis. In a 1982 study profiling interstate activities, banking organizations were found to control over 7,500 interstate banking offices, consisting primarily of loan production offices for commercial businesses, Edge Act offices for international banking activities, and nonbanking subsidiaries of multibank holding companies.2 Interstate nonbanking subsidiaries of multibank holding companies numbered 5,000 and engaged in activities such as consumer and commercial finance, mortgage banking, leasing, trust servicing, and trust services. Currently, the nonbanking activity that is being aggressively pursued by larger banks is the acquisition of interstate industrial banks. An industrial bank is a state-chartered institution that can accept deposits and originate loans, but cannot offer checking accounts. Interstate acquisitions of financially weak banks and thrifts are also eroding the barriers to interstate banking. An example of this is Citicorp's recent acquisitions of sizable thrifts in Chicago, Miami, and San Francisco, authorized by the Garn-St Germain Act. Such acquisitions in effect are back doors to interstate banking.

Also contributing to the development of nationwide banking is the tremendous growth of interstate automated teller machine (ATM) networks. Currently, there are approximately 200 regional and 7 national shared ATM networks.
Legal Restrictions on Interstate Banking

The federal legal restrictions on banks' geographic expansion were raised by the Bank Holding Company Act of 1927, which was amended by the Banking Act of 1933, and the Bank Holding Company Act of 1956 (BHCA). The BHCA authorized a nationally chartered bank to branch only in the city where its main office was located and only if state-chartered banks were permitted. The Banking Act of 1933 liberalized the branching powers of state-chartered banks, allowing them to branch in the same state as the state-chartered bank that was granted the same authority. The state boundary was effectively established as the limit for bank branching. Prior to the passage of the BHCA, banks could acquire out-of-state banks through multibank holding company networks. However, Section 2(b) of the BHCA, known as the Douglas Amendment, prohibited interstate bank acquisitions unless the state where the acquired bank was located specifically permitted such entry. Until 1975, no state permitted such entry.

Public Policy Issues

A report prepared by the Carter administration examined whether the public would benefit if interstate banking barriers were lifted. One support for lifting interstate banking restrictions is that the concentration of commercial banking resources, reversing a trend toward less concentration. If interstate barriers were eliminated, sizable banks would compete for deposits and transfer funds between local and metropolitan areas. A few very large banks are also geographically decentralized as a result of federal legislation and court rulings. Interstate ATMs cannot, however, accept deposits for out-of-state branches. Therefore, the banks are purchasing significant numbers of ATMs to provide a fairly comprehensive set of services to their customers.

Concentration and Competition

Perhaps the most controversial issue is whether the countervailing power that exists in large markets will be reduced by allowing out-of-state banks access to the market. The new laws have greatly increased the number of banks in the market.

Through an interstate ATM link-up, an individual can obtain cash, check account balances, and transfer funds between accounts. Interstate ATMs cannot, however, accept deposits for out-of-state branches.

A few very large banks are also geographically decentralized as a result of federal legislation and court rulings. Interstate ATMs cannot, however, accept deposits for out-of-state branches.

In a national interval, interstate pooling of deposits is generally lowest when concentration of commercial banking resources, reversing a trend toward less concentration. If interstate barriers were eliminated, sizable banks would compete for deposits and transfer funds between metropolitan areas. Large banks' geographic expansion are the primary reasons for interstate banking. Pooling of deposits is generally lowest when concentration of commercial banking resources, reversing a trend toward less concentration. If interstate barriers were eliminated, sizable banks would compete for deposits and transfer funds between metropolitan areas.

Evidence that entry of bank holding company subsidiaries into new markets on a de novo basis would result in a more competitive structure. A study by Rose and Savage found that concentration in a local market would be more competitive since de novo entry rarely achieves effective market penetration.

Even if higher concentration levels resulted from lifting interstate banking barriers, the threat of potential entry would help ensure competitive behavior. To illustrate: although an aggressive bank might obtain a significant share of a market's deposits, its potential entry would, in effect, reduce the bank's profitability. However, the bank would be invited additional competitors into the market. The number of banks in the market and higher concentration levels are combined, the competition becomes more effective. Positive effects of competition are likely to occur. The linked oligopoly theory has been applied to the banking industry to analyze the competitive effects of multibank concentration. According to this theory, as multibank concentration increases, each bank in the market gains market share, and each bank in the market gains market share.

The linked oligopoly theory has been applied to the banking industry to analyze the competitive effects of multibank concentration. According to this theory, as multibank concentration increases, each bank in the market gains market share, and each bank in the market gains market share.

Evidence that large banks have no cost advantages over smaller banks underscores the ability of small banks to thrive without geographic restrictions. In fact, studies on scale economies in banking have found that banks are large economies of scale. Instead, the main advantage of large banks is that they have a larger market share and can therefore employ economies of scale.

Because of the soundness of banks is the cornerstone of public policy toward banking, the effects of fewer geographic restrictions on the solvency of banks deserve close attention. Loosening interstate banking restrictions would undoubtedly increase the number of insolvent or troubled banks. Most banks fail because of self-dealing, mismanagement, or illegal activity. Furthermore, studies show that the percentage of insolvent or problem banks may be more vulnerable. A recent study of banking failed banks casts doubt on some earlier studies, finding that competitive performance would not deteriorate as inter-state banking increased.

Service, Survival, and Soundness

Some analysts contend that local banking services would deteriorate as interstate banking increases. Studies examining local financial services in states that authorized multi-office banking tend to dispute this contention. On the contrary, small communities in states that permit multi-office banking experienced improved banking services, including higher loan rates, higher deposit interest rates, and more loan extensions. While it is not known whether the larger credit volume was made to borrowers within local communities in which a bank had opened offices, evidence showed that lenders had systematically transferred funds from banking offices in rural areas to the core urban areas. States permitting multi-office banking also experienced an increase in the number of bank failures, though the number of banking organizations had declined. Such evidence generally suggests that local communities are better able to compete with larger banks in acquiring deposits if interstate banking restrictions were eased.

 Interstate banking would reduce the number of banks. Small banks in particular contend that they would be overwhelmed by large banks. Multi-office banks and bank holding companies meet each other in geographic dispersed markets, less competitive. If this occurred, a firm's aggressive actions might provoke retaliation, or, at a minimum, lead to a reduction in market share. These competitive effects of concentration are likely to occur. A study of the effect of interstate banking on small banks found that the number of banks in a state increased by 8% after interstate banking was allowed. However, studies show that the percentage of insolvent or problem banks may be overestimated. A recent study of banking failed banks casts doubt on some earlier studies, finding that competitive performance would not deteriorate as inter-state banking increased.

$100 million accounted for only 25% of the state's statewide banking assets. Yet, California's banks with assets exceeding $100 million were able to earn, on average, a return on assets about the same as their out-of-state larger banks. In fact, many of the large banks' newly opened offices closed because of unprofitable operations or ineffective market penetration. These studies indicate that small banks can survive and compete with large banks in a geographically unrestricted banking environment.

Evidence that large banks have no cost advantages over smaller banks underscores the ability of small banks to thrive without geographic restrictions. In fact, studies on scale economies in banking have found that banks are large economies of scale. Instead, the main advantage of large banks is that they have a larger market share and can therefore employ economies of scale.
Legal Restrictions on Interstate Banking

The federal legal restrictions on banks' geographic expansion are the McFadden Act of 1927, which was amended by the Banking Act of 1933, and the Bank Holding Company Act of 1956 (BHCA). The McFadden Act authorized a nationally chartered bank to branch only in the city where its main office was located and only if state-chartered banks were permitted to branch.

The Banking Act of 1933 liberalized the branching of state-chartered banks, allowing them to branch in each state to the same extent that state-chartered banks in each state thus could determine its own branching structure, and the state boundary was effectively established as the limit for bank branching.

Prior to the passage of the BHCA, banks could acquire out-of-state banks through multibank holding companies. However, Section 3(b) of the BHCA, known as the Douglas Amendment, prohibited interstate bank acquisitions unless the state where the acquired bank was located specifically permitted such entry. Until 1975, no state permitted such entry.

In national states, interstate banks are subject to constraints based on their home state’s interest rate ceilings, rather than federal regulation. The national banks may choose to lower their interest rates below the state’s limit to attract deposits.

Public Policy Issues

A report prepared by the Carter administration examined whether the public would benefit if interstate banking barriers were lifted.


Concentration and Competition

Perhaps the most controversial issue of interstate banking is the effect of fewer restrictions on concentration among banks and the distribution of financial resources. At issue is whether interstate banking would foster better services, lower profits, and less concentrated banking resources.


In a national state, interstate banks may choose to lower their interest rates below the state’s limit to attract deposits.


Evidence suggests that entry of bank holding companies into new markets on a de novo basis would result in a more competitive structure.


Perhaps the most controversial issue of interstate banking is the effect of fewer restrictions on concentration among banks and the distribution of financial resources. At issue is whether interstate banking would foster better services, lower profits, and less concentrated banking resources.


Evidence suggests that entry of bank holding companies into new markets on a de novo basis would result in a more competitive structure.


Perhaps the most controversial issue of interstate banking is the effect of fewer restrictions on concentration among banks and the distribution of financial resources. At issue is whether interstate banking would foster better services, lower profits, and less concentrated banking resources.

In our dual banking system, state- and federally chartered banks currently operate in each of the 50 states. The dual banking system would be largely unaffected if interstate banking occurred through repeal of the Douglas Amendment. States would continue to regulate state-chartered interstate bank subsidiaries, and federal regulators would supervise those with federal charters. The repeal of the McFadden Act, however, to permit interstate branching would probably create some formidable problems. For example, jurisdiction over interstate branches of state-chartered banks would have to be allocated, and differences in state regulatory policies toward state-chartered banks would have to be resolved.

Conclusion

A growing number of states permit interstate banking, a trend that is pressuring federal legislators to relax interstate banking barriers. Evidence suggests that removing these barriers would encourage beneficial competition among banks. However, it is doubtful whether current antitrust laws are adequate to prevent the possible negative effects of geographically unrestricted banking. If antitrust laws were teamed with federal guidelines limiting the size of acquisitions, the adverse effects of higher concentration levels could be minimized, and consumers could benefit from the removal of interstate banking barriers.

Banking without Interstate Barriers

by Thomas M. Buynak, Gerald H. Anderson, and James J. Balazsy, Jr.

In today’s deregulated banking environment, more and more states are considering loosening their interstate banking restrictions. Ohio, Michigan, and Florida are three of about fifteen states currently considering interstate banking legislation. If such legislation were enacted, these states would join 15 other states that already allow some form of interstate banking. Most of the interstate banking laws are very restrictive as to who can enter and the powers of the entrants. States with the least restrictive laws include Alaska and Maine, which allow interstate banking with any state; New York, which allows interstate banking with any state that permits reciprocal entry; and Massachusetts, Connecticut, and Rhode Island, which allow banks from reciprocating states in New England to expand interstate and bar banks from entering from outside the region.¹

Conclusion

According to interstate banking opponents, removing barriers to interstate banking might bring on the consolidation of the banking industry into a few large banks. An example of such concentration is Canada’s banking structure, in which there are only 11 banks, each controlling on average about $25 billion in assets. However, advocates of interstate banking contend that geographic banking restrictions are anachronistic in today’s financial environment. Interstate banking barriers are being rendered ineffective by technological advances such as electronic funds transfer. Banks are also placed at a disadvantage as they increasingly compete with nonbanking firms, such as Merrill Lynch, Prudential-Bache, and Sears, that market financial services through nationwide networks.

De facto Interstate Banking

Despite legal restraints on interstate banking, banking organizations and their subsidiaries have established extensive interstate networks in the past 10 years. In fact, except for taking in retail deposits, some banks perform virtually all of their banking functions on an interstate basis. In a 1982 study profiling interstate activities, banking organizations were found to control over $500 interstate

1. The state legislatures of Georgia, Utah, and Kentucky have recently approved interstate banking bills.