the deposit share held by thrifts for the number of thrifts to determine if their competitive strength was related directly to their market position. If larger banks realize economies of scale or have some other advantages over smaller competitors, then bank size would have a positive influence on earnings. Credit unions are active competitors for consumer deposits and loans, and their presence and concentration in a market may exert downward pressure on bank earnings, although the magnitude of this competition depends on the type of market. Banks with higher concentration levels would be expected to earn higher profits in markets with stronger demand. We used market deposit growth from 1982 to 1985 to account for demand differences across markets. The statistical results, as determined by regression analysis and presented in table 4, confirm the hypothesis of strong competitive pressures on banks.

Economic and legislative changes have changed the local actions of commercial banks and thrift institutions. Commercial banks traditionally offered a unique cluster of products that were not available from other institutions. Because of the expanded powers of thrift institutions in the early 1980s, however, thrifts have been operating more like commercial banks, providing a wide range of services, including checking accounts and business loans. As a result, banking regulators are concerned about the threat of entry in larger markets and about the competitive forces at work in the marketplace. In this view, the concentration of thrifts in local banking markets is exerting downward pressure on bank earnings. Our findings suggest that regulators and banking regulators when evaluating the possible anticompetitive impact of bank mergers. Some analysts downplay the importance of market structure, reasoning that the structure itself may be a product of the competitive forces at work in the market. In this view, the concentration is unlikely to lead to collusion and excessive profits when barriers to entry are low. In this view, price and quality of the services provided by banking regulators when evaluating the possible anticompetitive impact of bank mergers. Some analysts downplay the importance of market structure, reasoning that the structure itself may be a product of the competitive forces at work in the market. In this view, the concentration is unlikely to lead to collusion and excessive profits when barriers to entry are low. In this view, price and quality of the services provided by thrift institutions are required by law to prevent bank mergers and acquisitions that would have substantially adverse effects on competition. Banking regulators and the Justice Department are required to prevent bank mergers and acquisitions that would have substantially adverse effects on competition.

Bank regulators rely largely upon a structure-performance framework that considers both market structure (e.g., number and size distribution of competitors in a market) and important determinant of bank performance. With this line of reasoning, the fewer the number of competitors and the larger the share of the market controlled by the largest competitor, the greater the likelihood that firms will be able to charge prices above their competitive level. This line of reasoning is the same line of reasoning when evaluating the possible anticompetitive impact of bank mergers. Some analysts downplay the importance of market structure, reasoning that the structure itself may be a product of the competitive forces at work in the market. In this view, the concentration is unlikely to lead to collusion and excessive profits when barriers to entry are low. In this view, price and quality of the services provided by thrift institutions are required by law to prevent bank mergers and acquisitions that would have substantially adverse effects on competition. Banking regulators and the Justice Department are required to prevent bank mergers and acquisitions that would have substantially adverse effects on competition.

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the presence of thrifts does not alter bank earnings, it would be consistent with the view that thrifts are not as important as banks when gauging banking competition.

On the other hand, if bank earnings are significantly lower in markets with thrifts, then the actual level of overall competition for banking services in such markets is probably underestimated by not including thrifts as full competitors of banks. Such a finding, however, would not imply that thrift competition is equivalent to bank competition for all banking services.

The Strength of Thrift Competition
Thrift institutions compete aggressively with commercial banks, particularly since the early 1980s as a result of product and price deregulation for depository institutions. With their expanded powers, thrifts have essentially the same banking services as commercial banks. Yet banking agencies and the Justice Department do not generally treat thrifts as banks when assessing the competitive effects of proposed bank mergers.

For example, the Federal Reserve Board usually counts thrift deposits only at half the market level while bank deposits are counted at their full market level. In essence, the Federal Reserve argues that the competitive influence of a thrift is much less than that of an equal size bank. The reasons for this position stem from the fact that many thrifts are not active business lenders and that business loans account for only about 7 percent of their total loans.

However, some banks also make relatively few commercial and industrial loans, yet regulators consider all banks equally according to their deposits in the relevant market area. A thrift bank can thus exert considerable influence in many instances because it is far less than a full-size bank. We show some evidence that thrifts have been willing to accept more heavily subsidized services for commercial customers. In contrast, banks have depended more on noninterest-bearing demand deposits and capital requirements are lower at thrifts, which may give them a cost advantage over banks.

Simple cartel theory suggests that the presence of a limited number of firms reduces the incentive for collusion. From this perspective, thrifts might be expected to have a greater competitive effect in the market today than additional banking organizations, particularly in markets with only a few competitors.

Sample and Method Used
The impact of thrift competition on bank earnings is examined using recent data for a sample of 314 banks located in 14 states. These banks are head-quartered in nine states located in the eastern and central parts of the United States and operate in one- and two-bank rural markets where they generate all or most of their deposits. The sample was limited to those banks to minimize the effects of regional economic conditions and to isolate the effects of additional competitors on bank profitability. None of the thrifts in the sample have been significantly affected by the depressed energy and farm sectors of the economy. These factors have generally been largely affected by the depressed energy and farm sectors of the economy.

The authors suggested several explanations for the higher deposit rates paid by thrifts. Compared to banks, thrifts hold more long-term assets, so they have an incentive to pay higher rates on longer-tenure liabilities in order to match maturities and reduce interest rate risk. Thrifts have also traditionally relied much more heavily on retail time and savings deposits and have tended to pay lower deposit rates.

In contrast, banks have depended more on noninterest-bearing demand deposits and capital requirements are often lower in small rural markets.

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For example, the Federal Reserve Board usually counts thrift deposits only at half the face value level, whereas bank deposits are counted at full market level. In essence, the Federal Reserve is assuming that the competitive influence of a thrift is much less than that of an equal-size bank in the market if the thrift is separated from the bank system stems from the fact that many thrifts are not active business lenders and that business loans account for a very small portion of their total loans.

However, some banks also make relatively few commercial and industrial loans, yet regulators consider all banks equally according to their deposits in the relevant market, whereas thrifts that are not presently extending business loans still provide banks with potential competition for these loans.

Other factors also support the inclusion of thrifts as full competitors of commercial banks in the eastern and southeastern markets. The removal of interest-rate ceilings on deposits gave banks and thrifts freedom to compete for deposits on the basis of rates. Deposit-rate surveys, including a deposit-rate survey by Mahoney and O'Brien, show that thrifts consistently offer higher average deposit interest rates on all but smaller deposits compared to commercial banks. Although deposits on larger amounts are generally subject to federal interest-rate ceilings on deposits, the difference in rates is significant. The extent of the gap in rates has generally been greatly affected by the depressed energy and farm sectors of the nation. These sectors have been largely responsible for the record number of bank failures in recent years, and the failure of thrifts with more than 600 bank failures since 1981 have taken place west of the Mississippi.

Moreover, the Federal Reserve has estimated that thrifts, by their lower operating costs, indicate an anticompetitive effect unless other factors indicate that the Hirschman Index is less than 500 points unless other factors indicate that the HHI is calculated by adding the squared market share of each competing institution.

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In addition to these differences between banks and thrifts, capital structure and operating costs are lower for thrifts in markets with which they can give a cost advantage over banks. Simple cartel theory suggests that the greatest difference in the extent of competition is the presence of a thrift in an area could be related to profits earned in that market. Even if the returns are mean-reverted over the long term, the fluctuation is considerable in the market today as well as in the past, particularly in markets with only a few competitors.

Sample and Method Used
The impact of thrift competition on bank earnings is examined using recent data for a sample of 314 banks located in 14 states. These banks are headquartered in the eastern and southeastern United States and country and operate in one and two thrift regions where they generate all or most of their deposits. The sample was limited to those banks that minimize the effects of regional economic characteristics. Table 1 provides a list of the sample. The sample generally have been greatly affected by the depressed energy and farm sectors of the nation. These sectors have been largely responsible for the record number of bank failures in recent years, and the failure of thrifts with more than 600 bank failures since 1981 have taken place west of the Mississippi.

The sample was restricted to one-and-two-thrift markets that are approximately the same, so if the earnings differences are significant. The sample includes all banks that operate in markets without another thrift. The sample included only those thrifts that have a market share of 5 percent or less based on deposits.

We show the average earnings differences between groups and denote which ones are statistically significant in table 2. As an example, the earnings differences were significantly lower for the group of banks located in markets with thrift competition. Bank earnings dropped 1.10 percentage points in assets in markets with thrifts, regardless of the number of banks. In contrast, the sample banks earned 1.45 percent on assets in markets without any thrifts or other banks.

We also show average earnings differences between groups and denote which ones are statistically significant in table 1. As an example, the earnings differences were significantly lower for the group of banks located in markets with thrift competition. Bank earnings dropped 1.10 percentage points in assets in markets with thrifts, regardless of the number of banks. In contrast, the sample banks earned 1.45 percent on assets in markets without any thrifts or other banks.

The findings of the sample banks and various comparisons of those earnings are presented in table 1 through 4. Table 1 shows the range and average earnings of the total sample and the sample broken down by the number and type of competitors. Despite the two-year average individual bank earnings varied widely. Nevertheless, average returns on assets were consistently lower for the group of banks located in markets with thrift competition. For instance, the sample banks earned 1.10 percentage points in assets in markets with thrifts, regardless of the number of banks. In contrast, the sample banks earned 1.45 percent on assets in markets without any thrifts or other banks.

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Table 1 - Bank Earnings and Market Competitors

<table>
<thead>
<tr>
<th>Average Percent Return on Assets</th>
<th>Mean</th>
<th>Range</th>
<th>Observations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Sample</td>
<td>1.18</td>
<td>-0.61 to 2.17</td>
<td>314</td>
</tr>
<tr>
<td>Thrifts</td>
<td>1.10</td>
<td>-0.69 to 2.15</td>
<td>175</td>
</tr>
<tr>
<td>Thrifts, two banks</td>
<td>1.09</td>
<td>-0.66 to 2.13</td>
<td>74</td>
</tr>
<tr>
<td>Thrifts, one bank</td>
<td>1.02</td>
<td>-0.63 to 2.13</td>
<td>63</td>
</tr>
<tr>
<td>Two banks</td>
<td>1.19</td>
<td>-0.65 to 2.17</td>
<td>233</td>
</tr>
<tr>
<td>One bank</td>
<td>1.57</td>
<td>-0.62 to 2.73</td>
<td>51</td>
</tr>
</tbody>
</table>

Table 2 - Earnings Differences Across Market

<table>
<thead>
<tr>
<th>Differences</th>
<th>Mean</th>
<th>Range</th>
<th>Observations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Thrifts versus no thrifts</td>
<td>-0.13</td>
<td>-0.26 to 0.00</td>
<td>16</td>
</tr>
<tr>
<td>Thrifts, two banks versus no thrifts</td>
<td>-0.35</td>
<td>-0.48 to 0.00</td>
<td>3</td>
</tr>
<tr>
<td>Thrifts, one bank versus no thrifts</td>
<td>-0.13</td>
<td>-0.26 to 0.00</td>
<td>16</td>
</tr>
<tr>
<td>Two banks versus one bank</td>
<td>-0.22</td>
<td>-0.35 to 0.00</td>
<td>16</td>
</tr>
</tbody>
</table>

Table 3 - Earnings Differences Between Sample and Nonsample Banks

<table>
<thead>
<tr>
<th>Differences</th>
<th>Mean</th>
<th>Range</th>
<th>Observations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nonsample banks</td>
<td>0.85</td>
<td>-0.34 to 0.34</td>
<td>25</td>
</tr>
<tr>
<td>Nonsample banks, two banks</td>
<td>0.84</td>
<td>-0.34 to 0.34</td>
<td>9</td>
</tr>
<tr>
<td>Nonsample banks, one bank</td>
<td>0.92</td>
<td>-0.31 to 0.34</td>
<td>16</td>
</tr>
<tr>
<td>One bank</td>
<td>0.78</td>
<td>-0.66 to 0.20</td>
<td>19</td>
</tr>
</tbody>
</table>

Table 4 - Average Percent Return on Assets

<table>
<thead>
<tr>
<th>Nonsample banks*</th>
<th>Differences</th>
<th>Mean</th>
<th>Range</th>
<th>Observations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total sample</td>
<td>-0.52</td>
<td>-0.69 to 0.12</td>
<td>16</td>
<td></td>
</tr>
<tr>
<td>Thrifts, two banks</td>
<td>-0.51</td>
<td>-0.69 to 0.12</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>Thrifts, one bank</td>
<td>-0.51</td>
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the deposit share held by thrifts for the number of thrifts to determine if their competitive strength was related directly to their market position. It is quite possible for smaller institutions not to be viable competitors in a less-regulated environment. If larger banks realize economies of scale or have some other advantages over smaller competitors, then bank size would have a positive influence on earnings.

Credit unions are active competitors for both borrower deposits and loans, and their presence and concentration in a market may exert downward pressure on bank earnings. We also found that banks in markets where thrifts held a larger share of the deposits earned significantly lower returns on assets.

13. We found usable observations in the following states: Alabama, Arkansas, Florida, Georgia, Illinois, Indiana, Kentucky, Michigan, Mississippi, Pennsylvania, South Carolina, Virginia, West Virginia, and Wisconsin. Arkansas banks were included in the sample because their earnings were relatively stable, and many Arkansas banks met our other sample criteria.


15. The competitive influence of banks located outside of these markets is generally considered weak compared to the threat of entry in larger banking markets.

16. This earnings difference, however, was statistically insignificant.

17. The competitive influence of banks located outside of these markets is generally considered weak compared to the threat of entry in larger banking markets.

18. We found no evidence to support the view that thrift competition is inferior to bank competition—at least in terms of impact on bank earnings. Although the competitiveness of thrifts could vary widely across markets, we found that banks in markets where thrifts held a larger share of the deposits earned significantly lower returns on assets.

ECONOMIC COMMENTARY

Economic and legislative changes have changed the nature of the competition between commercial banks and thrift institutions. Commercial banks traditionally offered a unique combination of products that were not available from other institutions. Because of the expanded powers of thrift institutions in the early 1980s, however, thrifts have been operating more like commercial banks, providing a wide range of financial services, such as checking accounts and business loans.

As a result, bank regulators have taken steps to minimize the competitive threat posed to bank earnings. Some analysts downplay the importance of market structure, reasoning that the structure itself may be a product of the competitive forces at work in the market. In this view, market concentration is unlikely to lead to collusion and excessive prices, and competitive discipline on market structure.

Some of the Federal Reserve’s recent statements about bank organization and operation of banks have been strongly contested by various groups. This deregulation, along with technological innovations and increased customer sophistication, has fostered an expanding number of financial services. This has made it more difficult and expensive for regulatory agencies to determine the competitive impact of the thrift industry.

Bank regulators have regulated market competition and examined earnings differences among institutions. These developments have made competitive assessments of bank earnings more difficult and open to considerable debate.

Bank regulators rely largely on a structure-performance framework that notes that the market structure (number and size distribution of competitors in a market) is an important determinant of bank performance. With this in mind, we shall look at some recent developments in the banking industry.

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