

**PROSPERITY AND PERSONAL  
BANKRUPTCY**

**WALKING THE TIGHTROPE:  
PUBLIC ASSISTANCE AND  
WORK INCENTIVE**

**THE BANK-INCOME DERBY  
IN THE THIRD DISTRICT**



**AUGUST 1971**

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**BUSINESS REVIEW**

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**Prosperity and Personal Bankruptcy**

... Probing the paradox of personal bankruptcy amid prosperity points up the need for some fresh thinking and fundamental changes.

**Walking the Tightrope:  
Public Assistance and Work Incentive**

... Does it pay to be employed in Pennsylvania?

**The Bank-Income Derby in the Third District**

... Last year's experience indicates that bank managers might have to look to nontraditional sources of revenue to boost future earnings performance.

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# Prosperity and Personal Bankruptcy

by Duane G. Harris

The year of the consumer — 1971! Businessmen, economists, and policymakers anxiously await the day when the consumer unleashes his pent-up desires and dollar bills to speed the recovery process. While many people indeed may stampede the department store, auto dealer, and appliance shop, the recent downturn has taken its toll. Even though some consumers may have hoarded their income to spend on a brighter day, others lost out as their income ceased to service the debt they had run up during better times. For many that meant bankruptcy.

Although financial failure is nothing new, recent trends in bankruptcy cases have many people alarmed. During the unparalleled prosperity of the '60's, the number of debtor-relief cases practically doubled, causing personal bankruptcies per 1000 households to soar above that for the years during the depths of the Great Depression.

So, while economic downturns may result in their share of bankruptcies, it is evident

that there must be other fundamental causes for the failure trend. The resolution of the paradox of prosperity and personal bankruptcy, however, lies tangled in the complexity of bankruptcy law, a host of facts and figures, and a myriad of probable causes for bankruptcy. Yet we must probe the intricacies of the bankruptcy story if we are to begin to sort out its causes and its costs and benefits to consumers and businessmen.

## **PRELUDE: SOME INS AND OUTS OF DEBTOR RELIEF**

The roadmap to debtor relief is provided by the Federal Bankruptcy Act with a little help from state statutes. Title 11 of the United States Code gives the detail for individuals and corporations seeking financial restitution. Two sections of the Code, which constitute what are commonly referred to as "straight bankruptcy" and the "wage-earner plan," are particularly relevant to financially strapped individuals.

Straight bankruptcy is a legal process



whereby a debtor's assets are collected by the court, sold for cash (except for certain assets which are exempt—see box), and the proceeds distributed among his creditors. The debtor is *discharged* from his unsatisfied debts through the straight bankruptcy process.<sup>1</sup> The wage-earner plan, unlike straight bankruptcy, presents a blueprint to scale-down or extend an individual's debts. The intent of this plan is to permit a wage earner to pay existing debts out of future earnings without being bothered by creditors. (For a more detailed discussion, see Appendix.)

Straight bankruptcy has been a much more popular avenue of relief than the wage-earner plan. Since 1955, straight bankruptcy cases have accounted for over 80 per cent of total personal petitions nationally and over 90 per cent in all Third District states.

### THE GLUT OF PERSONAL FAILURES

Bankruptcy petitions filed have increased rapidly, especially in the last 15 years. The number of petitions filed nationally has more than tripled—from nearly 60 thousand in 1955 to nearly 185 thousand in 1969.<sup>2</sup> New Jersey, Pennsylvania, and Delaware likewise have experienced a sharp growth in the number of bankruptcy cases filed in District Court. In 1969, the number of cases filed in these states respectively doubled, tripled, and quadrupled the number filed in 1955.

<sup>1</sup> Bankruptcy is not the same as insolvency. Insolvency as defined in Title 11 means that the total present value of all the debtor's property is insufficient to pay his debts. In other words, his total liabilities exceed his total assets. Thus, a debtor may be insolvent without being bankrupt. His assets may not cover his liabilities, but until he has initiated judicial proceedings or a court has so adjudged, he is not considered bankrupt.

<sup>2</sup> Petitions filed are for fiscal years.

## WHAT THEY CANNOT CARRY AWAY

To give the bankrupt a running start again after he is absolved of his debts through straight bankruptcy, each state provides a list of assets which are exempt from liquidation. If the bankrupt claims these exemptions, the trustee, who collects the debtor's assets, sets apart the property and reports its value to the court.

Exemptions, however, vary in number and value from state to state and reflect the cultural and social heritage of the area. For example, Delaware hardly lets you get away with the clothes on your back—only \$50 worth of property including apparel and tools of trade are exempt. Pennsylvania exempts \$300 in personal property including wearing apparel; New Jersey, goods to the value of \$500 and all apparel.

In contrast, Iowa, reflecting an agrarian tradition exempts, among other things, one-half acre in a city or town or, otherwise, a homestead up to 40 acres; all wearing apparel of the debtor and his family; one musket or rifle and shotgun; all private libraries, family bibles, portraits, pictures, and musical instruments; a seat or pew occupied by the debtor's family in a house of public worship; cemetery plots not exceeding one acre; two cows and two calves, 50 sheep and their wool, six stands of bees, five hogs and all pigs under six months, up to \$50 worth of poultry, and enough feed to keep these animals for six months. Also exempt are household items such as bedsteads, bedding, furniture up to \$200, a sewing machine, and all spinning wheels, plus the proper tools of



the debtor's trade. And, if the debtor uses a team of horses, mules, or oxen in his livelihood, these animals, along with proper harness and wagon, are exempt. Otherwise, one horse can be kept.

Texas exempts 200 acres if not in a town or city along with many other exemptions similar to those mentioned for Iowa. California, which has a more modern revision of the law (1970) and less agricultural influence than Iowa or Texas, allows a homestead of up to \$20,000 in actual cash value over and above all mortgages on the property. This applies to the head of a family or persons over age 65; otherwise, up to \$10,000 in value is exempt. In addition, numerous household items, tools of the debtor's trade, and livestock are exempt.

So, just what exemptions are allowed can help set the tone of the lives of the debtor and his family after bankruptcy.\*

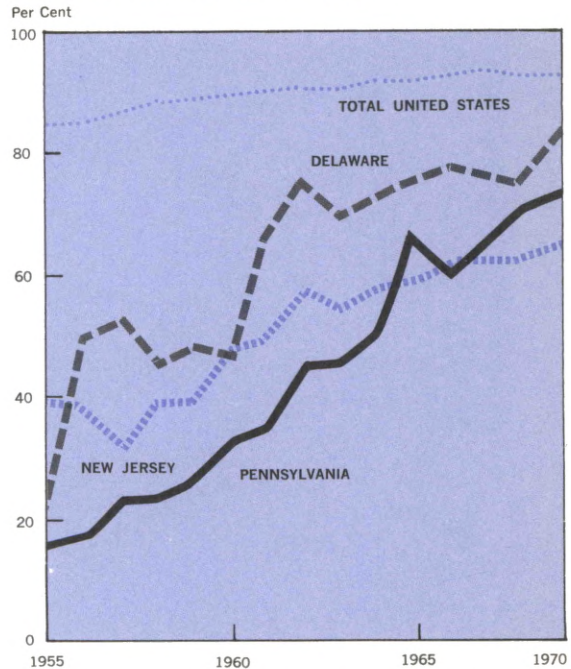
\*Generally, exemptions are allowable only for natural persons and not corporations.

Personal bankruptcy cases<sup>3</sup> for the nation as a whole have worked their way upward since 1955 to the point where they now account for over 90 per cent of total petitions filed (Chart 1). Comparable figures for Third District states show that personal bankruptcies have soared since 1955, so

<sup>3</sup> Personal bankruptcy cases are considered to be those designated by the Administrative Office of the United States Courts as "nonbusiness." These cases include those of employees and others not in business.

**PERSONAL PETITIONS ACCOUNT FOR THE LION'S SHARE OF BANKRUPTCIES.**

**CHART 1  
VOLUNTARY NONBUSINESS PETITIONS AS A FRACTION OF TOTAL PETITIONS.**



Source: Administrative Office of the United States Courts, *Tables of Bankruptcy Statistics*.

that they now constitute 60 to 80 per cent of total cases (Chart 1).<sup>4</sup> Consequently, the growth in bankruptcy petitions has been predominantly caused by personal failures.

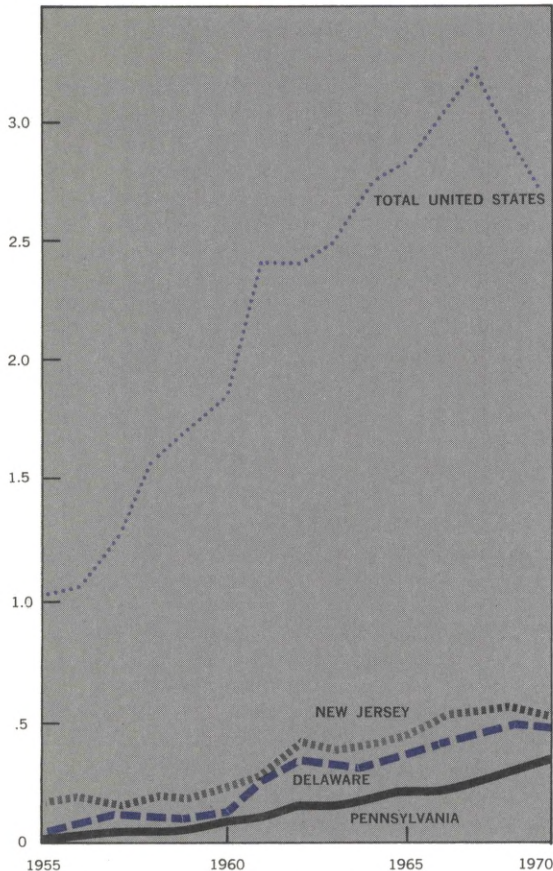
But the upsurge may not be so dramatic as it seems. Part of the skyrocketing increase in personal bankruptcies may merely reflect population growth. Chart 2 traces the pattern in personal failures per 1000

<sup>4</sup> Personal bankruptcies have accounted for a larger fraction of the total for the nation than for Third District states in every year since 1955. However, the growth in the personal percentage has been much more dramatic for New Jersey, Pennsylvania, and Delaware.



**CHART 2**  
**INCREASES IN PERSONAL BANKRUPTCIES**  
**HAVE OUTSTRIPPED POPULATION GROWTH.**

Number of Personal Petitions  
 Per 1000 Households



Source: "Sales Management, Survey of Buying Power," Administrative Office of the United States Courts, *Tables of Bankruptcy Statistics*.

households for the nation and for Delaware Valley states. Unfortunately, we find that taking population into account actually makes the "growth in personal bankruptcy" story even more severe, since increases in personal bankruptcies have outstripped household growth.<sup>5</sup>

<sup>5</sup>Cases-per-thousand-households in the Delaware Valley are far below the national average. In 1969, while Third District states showed 0.35 to 0.50 personal bankruptcies per 1000 households, the nation recorded a 2.72 figure.

## CAUSES OF THE UPSURGE

Although it is impossible to isolate conclusively the causes of the dramatic climb in personal bankruptcies without analyzing individual cases in detail, we can make some general comments. The growth in bankruptcies per 1000 households can mean two different things — either a greater portion of households are becoming insolvent, or more insolvent households are choosing bankruptcy.

**More Insolvents?** Part of the growth on the bankruptcy scene could be caused by more people becoming insolvent. Insolvency results because of inadequate provision for contractual commitments, such as bank loans and installment contracts, or unexpected emergencies, such as medical bills or need for a new roof. A trend to more insolvencies, therefore, could arise because of an increase in fixed commitments relative to resources or a decline in financial buffers against unexpected emergencies.

Drawn-out periods of prosperity may indeed breed greater commitments and thinner buffers. People become convinced that tomorrow will be at least as good as today. They rely on a "continuing" stream of income to build their assets and incur more debt because the prospect of default or other trouble seems remote.<sup>6</sup> They see no reason to forego the good things in life today when tomorrow will take care of itself.

In addition, prosperous times may lead individuals to adjust the mix of assets that they hold. Solvency depends upon the sale value of assets when liquidated. If individuals shift the allocation of their income from highly liquid assets, such as checking

<sup>6</sup>Since 1955, for example, households have been building up greater and greater consumer debt for each dollar of disposable income received. The ratio of consumer debt to disposable income increased from approximately 0.12 to 0.18 over the 1955-1970 period.



or savings accounts, to less liquid assets, such as consumer durables, they reduce the overall marketability of their asset holdings. Forced sale of assets to meet commitments or emergencies will bring a much lower return when assets are held in the form of durables. Furthermore, most consumer durables generate no income to help pay their way. Although economists long have noted that individuals purchase goods to maximize their utility (satisfaction), when the axe falls, it is mighty hard to pay off the banker with a bag of utility.

Thus, long periods of prosperity may breed unguarded optimism and result in increased debt or a mix of assets which will not provide adequate protection upon liquidation. Now, where do we attach the blame? Geraldine blames the devil, but that seems too easy. Undoubtedly, there are many interacting factors which lead people to face tomorrow on a thin string — keeping up with the Joneses and excessively generous credit, to name two. More than likely, both debtor and creditor have to share the responsibility for an individual's slide into insolvency.

**Or Just More “Bankrupt” Insolvents?** Not everyone who is insolvent files a bankruptcy petition. Many people probably struggle along and take care of their debts somehow. But the growth in personal bankruptcy could mean that given insolvency, more people now choose to declare bankruptcy. What could cause such a shift in behavior? Possibly, the Puritan Ethic is on the way out, so that hard work and financial responsibility are becoming less important. With the advent of credit cards, national sales networks, and gigantic credit mechanisms, there is much less need to deal with creditors face-to-face. Consequently, it may simply be less uncomfortable today to say, “I want out from under.”

Or it could be that the penalties associated with going bankrupt have diminished in recent years. Because we, as a society,

are more mobile, there may be very little stigma attached to going bankrupt today in Philadelphia and starting anew tomorrow in Allentown. If certain creditors have become more willing to dismiss past bankruptcies as an obstacle to future credit, then individuals may be less reluctant to take the legal remedy. Or, finally, it might be that the information process about bankruptcy has become more efficient. More people simply know that bankruptcy is a feasible alternative to their problems.

### THE BANKRUPTCY BURDEN

Of course, there are costs to the bankruptcy process. Debtors pay for bankruptcy through aggravation, loss of reputation, and so on. Creditors may find that they can recover virtually nothing via the bankruptcy route.<sup>7</sup> And the rest of us bear some of the burden also. To the extent that business passes on increased costs because of bad debt losses, we all pay for the debtor-relief process.

But so long as the future is uncertain, individuals will have imprecise notions about what's in store for them. And many will be caught in circumstances over which they have no control. If we are to lessen the burden to society of the debtor-relief process, we must be concerned with minimizing the number of cases where relief is necessary and with making the legal process as efficient as possible.

It is likely that many individuals fall into financial trouble because of lack of information about credit and proper budgeting. So, measures to streamline the information process are obvious candidates for action against insolvency. Truth-in-Lending legislation is one step to help bridge the information and knowledge gap. And there must

<sup>7</sup> For example, in 1969, in 85 per cent of total bankruptcy cases terminated, there were either no assets to be disbursed after exemptions, or the sale value of the assets was absorbed by the administrative costs of bankruptcy. More than likely, most personal bankruptcies leave little to be divided among creditors.

be many others. Creditors can take special care to assure that borrowers understand terms of agreement. Employers, credit unions, and other groups can do more to help provide budgeting guidance to interested individuals. Both debtors and creditors can support and utilize the credit-counseling activities sponsored by local groups.

Providing sources of complete information about financial matters, however, will only go so far. Information must be digested and used. Thus, it is clear that careful use of credit information rests squarely on the shoulders of the consumer. In a free-enterprise system where millions of individuals are making countless independent decisions, man must rely on his own initiative to guide his decisionmaking. If he chooses to short-cut the information-gathering process, he must live with the consequences — one of which may be insolvency.

And if the upsurge in bankruptcies has resulted from a change in attitude about the bankruptcy process, society is faced with a perplexing problem. Either we must readjust our thinking and institutions to accommodate the move to more bankruptcies, or we must attempt to shift debtor preference away from bankruptcy. But both require fundamental changes — prosperity and personal bankruptcy may remain strange bedfellows for some time to come. ■

## APPENDIX THROUGH THE LEGAL MAZE

### Straight Bankruptcy

If and when an individual decides he cannot keep his financial head above water, he can file a petition with the U.S. District Court, asking to become a *voluntary* bankrupt. Or, if creditors become worried about collecting from a debtor, they may bring

*involuntary* proceedings against him.<sup>1</sup> Then begins the legal process for the conversion of his property into cash.

The court appoints a bankruptcy-court referee, who has powers similar to those of a judge. The referee notifies all creditors, including those who may not have taken part in filing a petition, that a petition has been filed and schedules a meeting or a hearing to examine the debtor. After analyzing the debtor's position, the creditors try to determine what action they want to take. Some may try to block the petition, and if they succeed, the debtor's liabilities are not relieved. Or they may decide to take what they can get and vote to have the court appoint a trustee who takes control of the debtor's property.

In the simplest individual cases in which the debtor has no assets and the creditors do not oppose his petition, the referee will usually discharge the bankrupt after the routine hearing. However, in cases where there are assets or creditor opposition, the trustee is appointed.

The trustee is given title to the bankrupt's assets and has the responsibility of selling the assets for cash (except for the assets which are exempt) and rationing the proceeds among the creditors. However, some debts, such as taxes and court costs, must be paid out of these proceeds before the creditors get anything.

If the debtor is discharged by the court, either after the routine hearing or after the distribution of his assets, he is permanently released from the debts included in the bankruptcy petition.<sup>2</sup>

<sup>1</sup> However, involuntary proceedings cannot be instituted against a wage earner or farmer.

<sup>2</sup> Section 35 of Title 11 makes certain exceptions to the total discharge of the debtor. In particular, debts not affected by a discharge include (1) taxes; (2) liabilities for certain fraudulent acts, willful and malicious injuries, or immoral conduct; (3) alimony and support orders; (4) claims for wages earned within three months of the filing of the petition; and (5) claims of creditors not notified of the bankruptcy.



### The Wage-earner Plan

A wage earner (an individual whose principal income is derived from wages, salaries, and commissions) can voluntarily file a petition which declares that he is insolvent or unable to pay his debts as they mature, and

proceeding in time to submit their claims.

In addition, creditors may block the debtor's discharge by proving that the bankrupt is responsible for certain acts, such as an offense punishable by imprisonment, failure to keep or preserve adequate records, or dishonest transfer or concealment of assets, or if he has obtained a previous discharge within six years. If the creditors are successful in blocking the debtor's discharge, then his debts are not forgiven.

that he would like to present a plan to scale-down or extend the maturity of his debts. The advantage of this avenue to the debtor is that he can avoid the procedure and stigma of straight bankruptcy. Since a wage earner's only "asset" may be his future earning power, this provision allows him to turn over that asset to his creditors.

When the wage earner presents his plan to the court, a meeting is held to gain approval. If the creditors accept the plan and the court is convinced of its fairness and feasibility, it becomes binding, and the debtor's future earnings are controlled by the court to carry out the plan. He thus systematically meets a revised set of obligations to ease the burden of his original debt.

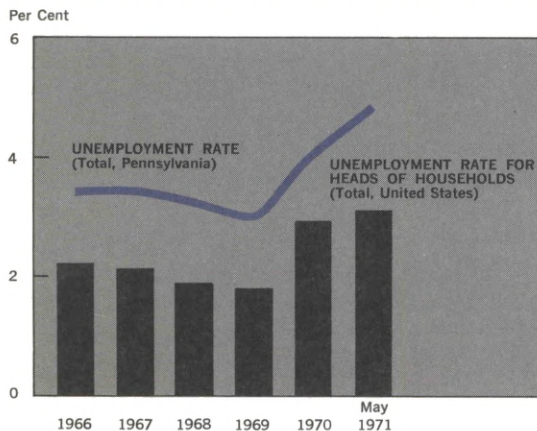
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# Walking the Tightrope: Public Assistance and Work Incentive

by Kathleen C. Holmes

## AS UNEMPLOYMENT CONTINUES TO RISE . . .



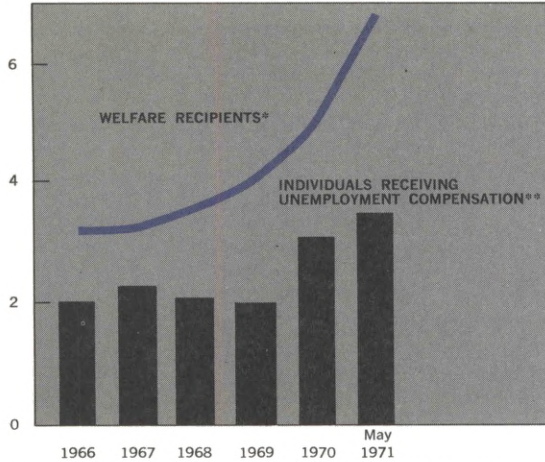
Source: Pennsylvania Department of Labor and Industry; U. S. Department of Labor, Bureau of Labor Statistics.

Although the economic downturn in 1970 was mild by historical standards, the rate of unemployment has almost doubled in Pennsylvania — rising from below 3 per cent in 1969 to nearly 6 per cent at last count. If Pennsylvania is like the nation, the number of unemployed heads of households — the chief breadwinners — has also jumped.



**MORE PEOPLE DEPEND ON THE COMMONWEALTH.**

Per Cent

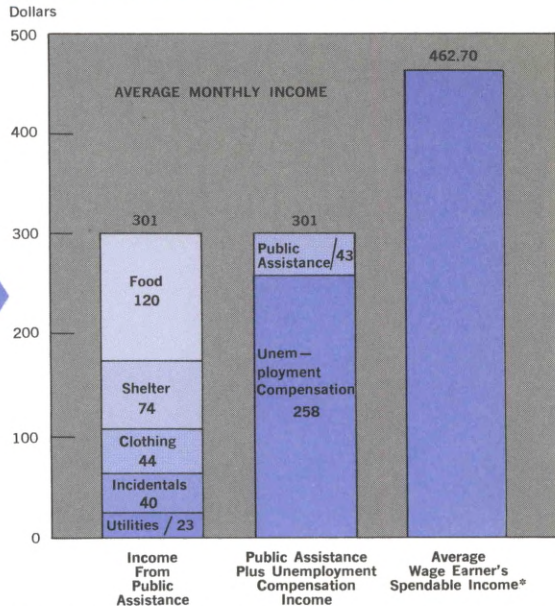


\*Percentage of Pennsylvanians receiving public assistance payments.  
 \*\*Insured unemployment as a percentage of the insured labor force in Pennsylvania.  
 Source: Pennsylvania Department of Public Welfare; Pennsylvania Department of Labor and Industry.

Unemployed family heads provide for their wives and children in several ways. Some borrow from friends, relatives, or lending institutions, or fall back on personal savings. For other families, however, the only solution is public aid. Consequently, the number seeking unemployment compensation has increased. Other jobless workers, who are ineligible for unemployment compensation, must look to welfare.

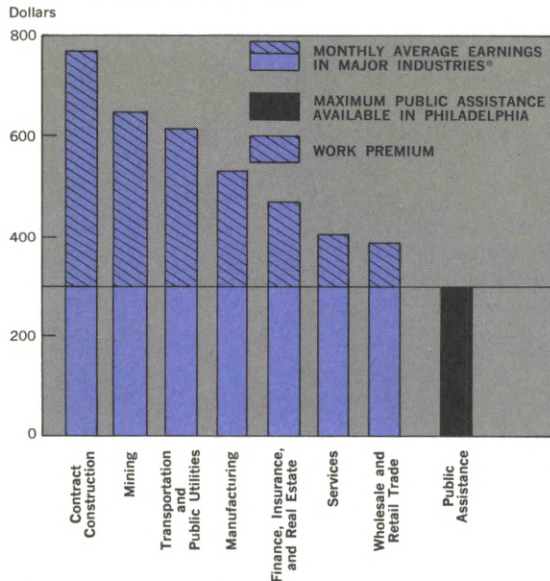
The unemployed worker in Philadelphia with a family of four is eligible for a maximum of \$301 a month of public assistance. If he qualifies and receives the maximum unemployment compensation of \$258, he may still receive \$43 in public assistance to bring him up to the \$301 level. However, if he is not eligible for unemployment compensation, the entire \$301 may still come from welfare. This \$301 in public assistance compares to \$462.70 netted by the average worker — for a “work premium” of \$162. That is, if he goes back to work full time, he will receive \$162 extra a month for his effort, (plus pride, sense of achievement, and other satisfactions he gains from productive activity). Of course, this “work premium” will vary, depending on the occupation of the worker and his place on the job ladder.

**PUBLIC ASSISTANCE CAN HELP . . .**



\*Spendable earnings of production and nonsupervisory worker with three dependents on private nonagricultural payrolls in the United States.  
 Source: Pennsylvania Department of Public Welfare; Pennsylvania Department of Labor and Industry; U. S. Department of Labor, Bureau of Labor Statistics.

**BUT PUBLIC AID CAN CONFLICT WITH WORK INCENTIVE.**



The size of the “work premium” may pose some problems in formulating public assistance programs. For higher paid workers in such industries as construction, this is not a difficulty because the “work premium” is large. But for other breadwinners in low-paying service and trade jobs, and for those people whose wages fall below the average in all industries, the “work premium” is likely to be small, and a significant work incentive problem may arise. Policymakers face a two-pronged dilemma — providing an adequate program of public aid to meet the needs of the unemployed without reducing incentive to work. ■

\*Spensible earnings of production or nonsupervisory workers with three dependents on private nonagricultural payrolls in the United States. Source: U. S. Department of Labor, Bureau of Labor Statistics.



# The Bank-Income Derby In The Third District

by Donald J. Mullineaux

Bank income in the Third District climbed to record levels in 1970, but the rate of growth of earnings fell short of the sweeping increases registered in 1969. While the performance of District banks as a group topped the national average, income growth varied widely across different classes of District banks. City member banks increased their earnings much more rapidly than their country and nonmember counterparts, primarily because of their superior noninterest income gains.

## RECORD LEVELS, BUT . . . .

How well any bank or group of banks performed in 1970 depends on which yardstick is used to measure earnings. For example, current operating income of all banks in the Third District increased 6.3 per cent over the 1969 level, but net income jumped over 11 per cent (see box for definitions). In both cases, these rates of increase

were smaller than the estimated increases in 1969.<sup>1</sup>

These measures of earnings are just two of several which appear in a bank's year-end income statement. The fact that interested viewers of the bank-income derby do not all agree on which constitutes the best standard of performance is unfortunate, because the order of finish depends on the particular profit gauge chosen. For example, in terms of growth in current operating income, city member banks clearly bested their country member counterparts and all

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<sup>1</sup> Precise estimates of income growth in 1969 require reconstruction of the 1968 income reports to conform with the changes in accounting procedures initiated in that year. For example, if these accounts are not adjusted, current operating income and net income at Third District *member* banks grew at over 14 and 24 per cent respectively. A rough reconstruction of the accounts suggests the actual changes were closer to 23 and 18 per cent, however.

### HOW SHOULD BANK EARNINGS BE MEASURED?

A perusal of a bank's year-end income statement indicates at least four different measures of income. Not surprisingly, bankers, accountants, economists, and investors disagree over which is the best indicator of earnings performance. Income before income taxes and securities gains or losses—formerly termed “net operating income”—is simply the difference between operating income (interest on investments, fees, service charges, and so on), and operating expenses (wages, benefits, interest on borrowed funds, occupancy and furniture expense). Since 1969, operating expenses also include a minimum provision for loan losses. After applicable income taxes are deducted—“income before securities gains and losses”—income can be measured net of the after-tax effects of securities gains or losses—“net income before extraordinary items.” Finally, if extraordinary charges or credits (such as changes in depreciation estimates, sale or abandonment of buildings) are affixed to this figure, and minority interest in consolidated subsidiaries is deducted, the result is “net income.”

Since a corporation's profits are usually reflected in both the dividend and capital-gains earnings on its equity shares, actual and potential investors in commercial banks are faced with the problem of determining which income measure to use in evaluating a bank's profit performance. Bankers and most bank-stock analysts have tradi-

tionally emphasized operating income as the best indicator of earnings ability. They argue that concentration of gains and losses in nonrecurring elements of income in a given year tends to misrepresent the economic characteristics of the banking industry by converting a relatively stable earnings stream into a fluctuating earnings stream.

Economists point out, however, that changes in the capital value of the investment portfolio are a continuing part of investment income and should be considered in evaluating bank-management performance. Since 1969, net *realized* securities gains or losses have been reported in bank-income accounts. This method of reporting has been criticized, however, because it violates the standard accounting rule that revenues should be attributed to the period in which costs were incurred to produce them. A bank in any given year might add and subtract gains and losses realized on transactions undertaken several years in the past. In addition, this procedure gives no indication of *unrealized* capital changes in the investment portfolio. It thus becomes quite difficult to accurately evaluate *current* performance of a bank's portfolio management on the basis of published data.

Until income-reporting procedures are adjusted to include *accumulated* capital changes in portfolios, the debate over the “best” earnings indicator is likely to continue unsettled.



nonmember banks as they chalked up a gain of better than 11 per cent, as shown in Table I. Nonmember banks outperformed country member banks by a margin of 1.5 percentage points.<sup>2</sup> If a trip to the winner's circle depends on growth of net income, city banks again emerge on top. However, country member banks take the place position by a margin of almost 5 percentage points over nonmembers.<sup>3</sup>

<sup>2</sup>From the viewpoint of individuals who "place their bets" in terms of investment dollars, the relevant comparison is between *individual* banks rather than classes of banks. Within any bank grouping, some banks perform better than the highest of the observed averages, while the earnings of others grow more slowly than the lowest average of any class of banks.

<sup>3</sup>This shift in ranking according to net income is accounted for by the following factors: (1) applicable income taxes were a larger percentage of current operating income at nonmembers than at country banks; (2) nonmembers experienced extraordinary charges of \$747 thousand net of tax effects, while country banks had extraordinary gains of \$620 thousand; (3) over \$152 thousand was deducted from current operating income of nonmembers as minority

Rising income alone is not a reliable indicator of a bank's earnings efficiency. Impressive profit figures may simply reflect overall growth in assets. Therefore, measures of earnings relative to portfolio size and to bank capital are also typically considered in discussions of profitability. Measures of operating income relative to assets were virtually unchanged at member banks in 1970 relative to the previous year, but declined by a small margin at nonmember banks. For member banks, therefore, the increases in operating income relative to capital shown in Chart 1 are mostly accounted for by larger holdings of assets per dollar of capital. While nonmember banks were the only group to suffer a decline in income ratios in 1970, their profitability levels still exceeded those of country member banks.

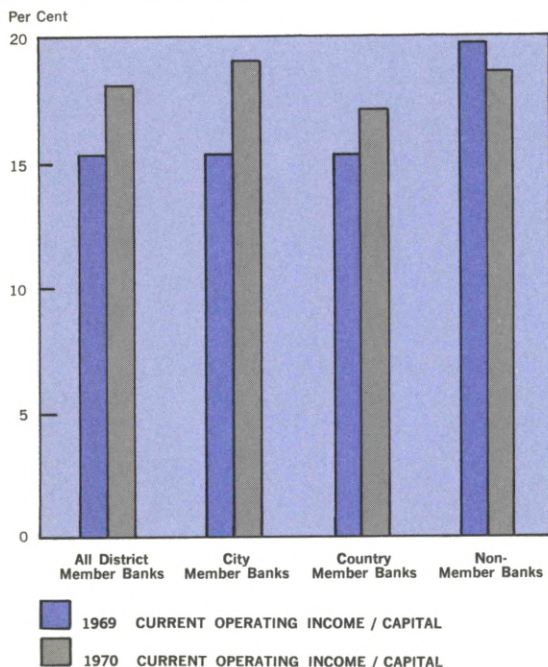
interest in consolidated subsidiaries, while country banks had no deduction in this category. Offsetting these factors, securities losses were a slightly larger percentage of operating income at country banks, but in both cases net losses were less than 1 per cent of operating income.

**TABLE 1**  
**CITY MEMBER BANKS OUTDO BOTH COUNTRY MEMBERS AND NONMEMBERS IN INCOME-GROWTH COMPETITION IN 1970.\***

| Percentage Change in:    | Third District Member Banks |              |                 | Third District Nonmember Banks |
|--------------------------|-----------------------------|--------------|-----------------|--------------------------------|
|                          | All Members                 | City Members | Country Members |                                |
| Current Operating Income | 7.0                         | 11.6         | 3.1             | 4.6                            |
| Net Income               | 12.7                        | 14.1         | 11.6            | 6.7                            |

\*These figures, which are derived from aggregate profit levels, are adjusted to account for shifts of banks from one category in 1969 to another last year.

**CHART 1**  
**RETURN ON CAPITAL INCREASED AT MEMBER**  
**BANKS IN 1970, BUT DECLINED AT**  
**NONMEMBER BANKS.**



**HIGHER YIELDS ON ASSETS FOR**  
**ALL THIRD DISTRICT BANKS**

Although short-term interest rates suffered their most precipitate declines in the post-war period in 1970, banks managed to earn higher average rates of return on all categories of portfolio assets (see Table 2). Philadelphia banks earned the highest percentage return on loans and Treasury securities, but had the lowest return on "other securities" (mainly state and local government obligations). Nonmember banks earned rates of return that were only slightly above those of country members in all three asset categories. Loans figured prominently in the asset mix of all Third District banks, but the proportion of loans to total assets was down from 1969.<sup>4</sup>

Country member banks experienced the largest increases in portfolio yields, and, consequently, far outpaced their counter-

<sup>4</sup>City banks led the way, holding more than 60 per cent of total assets in loans; nonmembers, about 58 per cent; and country members, 55.5 per cent.

**TABLE 2**  
**INCREASED PORTFOLIO YIELDS**  
**SPARK REVENUE GAINS.**

| Percentage Return on: | Third District Member Banks |      |              |      |                 |      | Third District Nonmember Banks |      |
|-----------------------|-----------------------------|------|--------------|------|-----------------|------|--------------------------------|------|
|                       | All Members                 |      | City Members |      | Country Members |      | 1969                           | 1970 |
|                       | 1969                        | 1970 | 1969         | 1970 | 1969            | 1970 | 1969                           | 1970 |
| Loans                 | 7.1                         | 7.8  | 7.4          | 8.0  | 6.8             | 7.6  | 7.7                            | 7.8  |
| Treasury Securities   | 5.1                         | 5.6  | 5.4          | 5.7  | 4.9             | 5.5  | 5.3                            | 5.5  |
| Other Securities      | 4.0                         | 4.3  | 4.1          | 3.9  | 3.9             | 4.4  | 4.2                            | 4.5  |



parts in *growth* of portfolio income. As the profit figures suggest, however, country banks had the most difficult time in moderating cost increases.

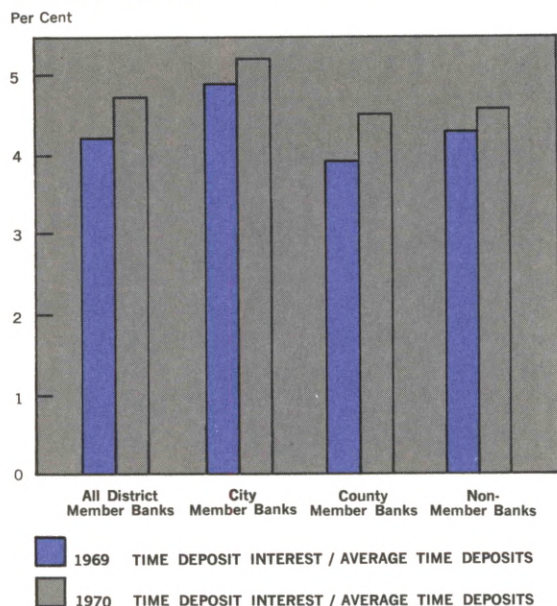
### BUT COST INCREASES ALSO SHARP

While increasing rates of return and larger asset holdings spelled substantial growth in revenues, Third District bankers struggled to allay the erosion of profits caused by rising costs. The average rates of interest paid on time and savings deposits, shown in Chart 2, soared to record levels in 1970 at all three types of banks. The increase in interest costs per dollar of deposit was noticeably more rapid at country banks than at city or nonmember banks. While Philadelphia banks paid the highest rates, these deposits constituted a much smaller proportion of their total deposits (40 per cent) than at banks in the other groups (59 per cent). As a result, interest on deposits

made up only about one-third of total expenses at city banks, compared to over 45 per cent at nonmember and country banks.

Rising costs were not restricted to interest payments during 1970. The major component of noninterest expense, salaries and wages plus employee benefits, increased nearly 11 per cent at city banks, 15 per cent at country banks, and a whopping 20 per cent at nonmember institutions. Provisions for loan losses, though a small component of total expenses, surged more than 60 per cent at city banks compared to its 1969 level. This minimum loan-loss contingency account rose 17 per cent at country members, but was unchanged at nonmember banks. Other expenses, such as occupancy expense, furniture and equipment, and depreciation showed more moderate increases. These rates of increase in noninterest costs generally outstripped those observed in 1969, and were an important factor in slowing earnings growth in 1970.

**CHART 2**  
**INTEREST RATES ON TIME DEPOSITS**  
**SKYROCKETED IN 1970, ESPECIALLY AT**  
**COUNTY BANKS.**



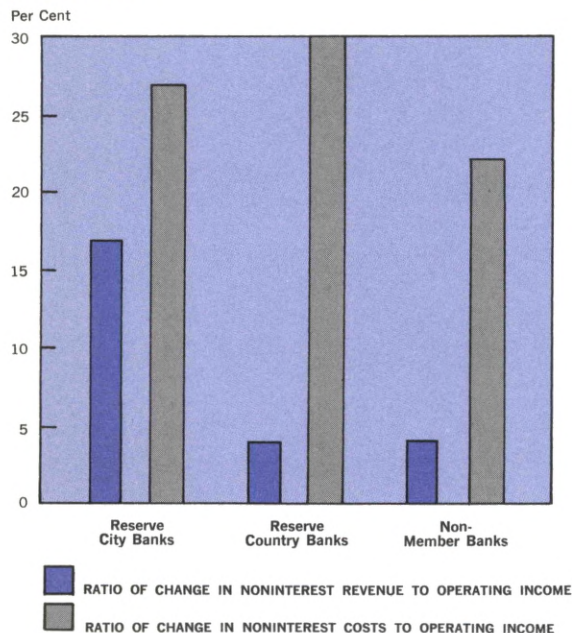
### NONINTEREST INCOME GAINS ACCOUNT FOR PHILADELPHIA BANKS' VIRTUOSO PERFORMANCE

Did the profit-growth performance of city member banks stem from superior portfolio management (better selection of assets and liabilities)? One rough measure of bank portfolio performance, a breakdown of the percentage increase in operating income into changes in *interest* revenues and costs versus *noninterest* revenues and costs, indicates that this may not have been the case.<sup>5</sup> Chart 3 shows the changes in noninterest revenues and costs in 1970 as a percentage of operating income in the previous year. A comparison of the heights of the revenue and cost bars shows that at city members the increase in noninterest costs

<sup>5</sup> Since both the income and costs associated with portfolio behavior involve more than consideration of interest, this procedure is clearly a crude reflection of actual portfolio management.



**CHART 3**  
**CITY BANKS CAPTURED INCOME-GROWTH HONORS BY COVERING MORE OF THEIR NONINTEREST COSTS WITH NONINTEREST REVENUES.**



exceeded the rise in noninterest revenues by only 10 per cent of 1969 operating income. At country banks, however, this difference was over 26 per cent. This disparity stemmed primarily from the fact that noninterest revenues increased much more rapidly at city banks in 1970 than at country member and nonmember banks. Since the difference between growth in *interest* income and *interest* cost (as a percentage of operating income) was *smallest* at Philadelphia banks, this relative gain in *noninterest* income was clearly the secret to the operating-income growth success of city member banks.

The major sources of these noninterest revenue gains for city banks were: (1) net earnings of *foreign* branches and subsidiaries, and (2) trading account income. The latter earnings represent the return from conducting a market in municipal securities.

Since both these activities require significant amounts of capital and expertise, they are not viable earnings alternatives for smaller banks. Nevertheless, last year's income figures do contain a valuable lesson for all bank managers. Since Philadelphia banks have expanded operations in these two specific areas on a large scale only in very recent years, engaging in activities functionally related to banking<sup>6</sup> apparently can boost bank earnings significantly within a relatively short period.

### THE FUTURE OF BANK EARNINGS

Bank earnings constitute the raw material of growth in the banking industry—a source of both internal and external finance. A competitive performance by commercial banks relative to other financial and non-financial businesses is, therefore, essential to continued growth of the industry.

In 1970, as interest rates declined, income from loans and investments rose less rapidly than interest expense. In the first half of 1971, Third District city banks reduced rates on time and savings deposits below legal ceilings. Although some country banks also lowered deposit rates, many continued to pay the highest rates allowed—at least on passbook-type accounts. For these banks, the interest-rate squeeze on earnings will be pitted against an accelerated rate of asset acquisition permitted by the increased rate of monetary expansion during the first two quarters.

Banks with large and increasing concentrations of time deposits appear to face the most difficult tasks in maintaining adequate growth in earnings. These banks hesitate to reduce the rate paid on such deposits for fear that competitors will attract not only

<sup>6</sup>The activities so closely related to banking as to be a "proper incident thereto" are currently being determined by the Federal Reserve Board under the 1970 Amendments to the Bank Holding Company Act.

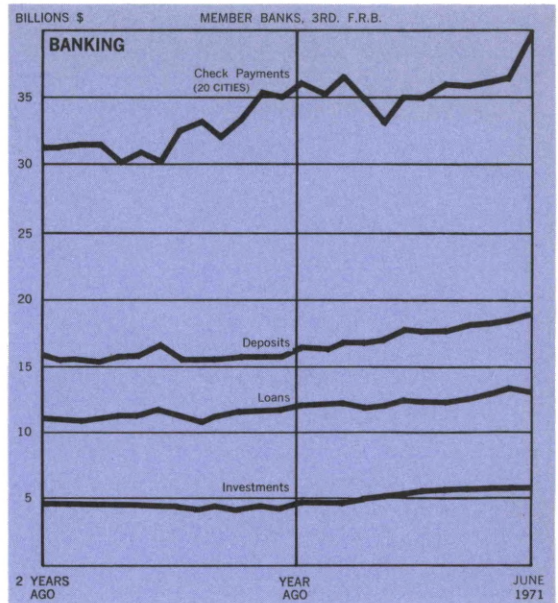
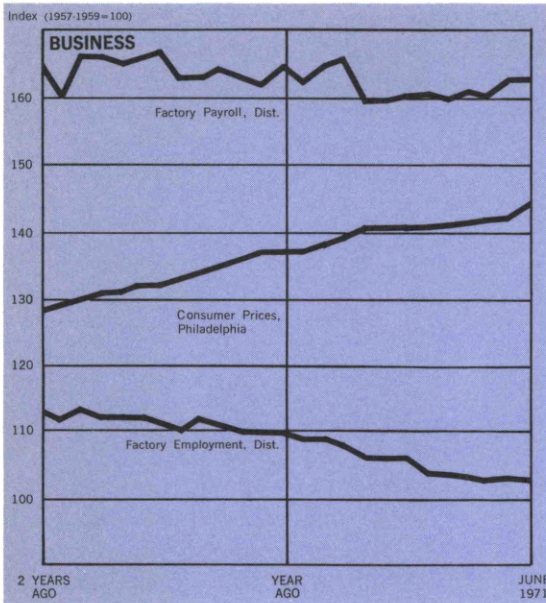


their time-deposit dollars but also their more lucrative demand-deposit accounts.

Over the longer term, more and more banks are likely to consider moving towards one-bank holding companies as a means of

broadening the base of income-earning activity. The experience of city banks in the Third District in 1970 demonstrates how expansion into broader areas of financial services can boost earnings performance. ■

# FOR THE RECORD...



| SUMMARY                              | Third Federal Reserve District |          |                  | United States   |          |                  |
|--------------------------------------|--------------------------------|----------|------------------|-----------------|----------|------------------|
|                                      | Per cent change                |          |                  | Per cent change |          |                  |
|                                      | June 1971 from                 |          | 6 mos. 1971 from | June 1971 from  |          | 6 mos. 1971 from |
|                                      | mo. ago                        | year ago | year ago         | mo. ago         | year ago | year ago         |
| <b>MANUFACTURING</b>                 |                                |          |                  |                 |          |                  |
| Production .....                     |                                |          | + 2              | - 1             | - 3      |                  |
| Electric power consumed              | + 5                            | + 1      | 0                |                 |          |                  |
| Man-hours, total*                    | - 1                            | - 8      | - 8              |                 |          |                  |
| Employment, total .....              | - 1                            | - 7      | - 7              |                 |          |                  |
| Wage income*                         | 0                              | 0        | - 1              |                 |          |                  |
| <b>CONSTRUCTION**</b>                | -43                            | - 5      | +15              | + 7             | +22      | +13              |
| <b>COAL PRODUCTION</b>               | - 9                            | + 2      | + 5              | - 4             | + 2      | + 9              |
| <b>BANKING</b><br>(All member banks) |                                |          |                  |                 |          |                  |
| Deposits .....                       | + 4                            | +20      | +16              | + 6             | +21      | +16              |
| Loans .....                          | 0                              | + 9      | +10              | + 2             | + 9      | + 7              |
| Investments .....                    | + 3                            | +31      | +26              | + 2             | +25      | +23              |
| U.S. Govt. securities                | + 2                            | +17      | +12              | + 3             | +19      | +17              |
| Other                                | + 3                            | +41      | +35              | + 2             | +29      | +27              |
| Check payments***                    | +10†                           | +16†     | - 1†             | + 6             | +17      | +15              |
| <b>PRICES</b>                        |                                |          |                  |                 |          |                  |
| Wholesale .....                      |                                |          |                  | 0               | + 4      | + 3              |
| Consumer .....                       | + 1‡                           | + 6‡     | + 6‡             | + 1             | + 4      | + 5              |

| LOCAL CHANGES<br>Standard Metropolitan Statistical Areas* | Manufacturing                  |          |                                |          | Banking                        |          |                                |          |
|---|--------------------------------|----------|--------------------------------|----------|--------------------------------|----------|--------------------------------|----------|
|   | Employment                     |          | Payrolls                       |          | Check Payments**               |          | Total Deposits***              |          |
|   | Per cent change June 1971 from |          | Per cent change June 1971 from |          | Per cent change June 1971 from |          | Per cent change June 1971 from |          |
|   | month ago                      | year ago | month ago                      | year ago | month ago                      | year ago | month ago                      | year ago |
| Wilmington .....  | 0                              | - 5      | + 3                            | + 5      | +21                            | + 4      | +11                            | +32      |
| Atlantic City .....                                       |                                |          |                                |          | +15                            | +23      | + 4                            | +34      |
| Trenton .....   | - 1                            | - 7      | - 1                            | 0        | 0                              | +32      | 0                              | +15      |
| Altoona .....   | + 2                            | - 4      | + 2                            | + 1      | +12                            | +24      | + 2                            | +14      |
| Harrisburg .....  | + 2                            | - 4      | + 6                            | 0        | 0                              | +12      | + 5                            | +15      |
| Johnstown .....   | + 1                            | - 3      | + 7                            | + 9      | +23                            | +43      | + 1                            | +20      |
| Lancaster .....   | + 2                            | - 7      | + 5                            | 0        | - 6                            | + 2      | + 2                            | +94      |
| Lehigh Valley .....                                       | - 2                            | - 9      | + 2                            | + 1      | + 8                            | +19      | + 3                            | +20      |
| Philadelphia .....  | - 2                            | - 8      | - 1                            | 0        | + 9                            | +17      | - 6                            | + 8      |
| Reading .....   | 0                              | - 4      | + 2                            | + 1      | + 2                            | +20      | + 3                            | +14      |
| Scranton .....  | + 1                            | - 4      | + 3                            | + 3      | + 7                            | +14      | + 3                            | +20      |
| Wilkes-Barre .....  | 0                              | + 4      | 0                              | +14      | +14                            | +22      | 0                              | +16      |
| York .....  | + 2                            | - 6      | + 3                            | 0        | +42                            | +62      | + 5                            | -38      |

|                                    |               |
|------------------------------------|---------------|
| *Production workers only           | †15 SMSA's    |
| **Value of contracts               | ‡Philadelphia |
| ***Adjusted for seasonal variation |               |

|   |
|---|
| *Not restricted to corporate limits of cities but covers areas of one or more counties. |
| **All commercial banks. Adjusted for seasonal variation.                                |
| ***Member banks only. Last Wednesday of the month.                                      |