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Scarcity Amid Affluence

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Bigger Slice of a Bigger Pie

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Spur Economic Growth?

FEDERAL RESERVE BANK of PHILADELPHIA

business review



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. . . Savings accounts now constitute nearly a quarter of household financial assets, and commercial banks are boosting their share of the market.

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. . . A particular style of banking organization may not be much of a spur to economic growth, according to "standard" growth measures.

On our cover: This cast house formed the heart of the furnace operations of the once-humming iron works of Hopewell Village, near Birdsboro, Pennsylvania. During the 1700s southeastern Pennsylvania became the center of early America's iron industry. Founded by Mark Bird, Hopewell Village became representative of the hundreds of ironmaking communities that met the new nation's industrial needs. Until surpassed by more modern methods, cold-blast charcoal-burning furnaces, such as that at Hopewell, supplied all the iron.

(Photograph by Richard Frear, courtesy of the U.S. Department of the Interior.)

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The Energy Crisis: Scarcity Amid Affluence^{*}

By David P. Eastburn, President
Federal Reserve Bank
of Philadelphia

A few weeks ago I experienced that increasingly familiar phenomenon of the metropolis, the blackout. As usually happens, everyone present took it in good humor, but in this case for a special reason: The head of the local power company had just left the party a few minutes earlier.

If the problem were not so serious, anyone with training in economics might take some grim satisfaction in these events, the most tangible manifestation of the "energy crisis." They demonstrate that resources really are scarce, as the economics textbook always said they were.

The sudden awareness that there are not enough energy resources to support indefinitely the expected demands on them has come as a shock to a society only recently beginning to believe that we can accomplish

anything we set our minds to. Not long ago, John Kenneth Galbraith persuaded many thoughtful and earnest people that we had solved the problem of production. As he put it:

To furnish a barren room is one thing. To continue to crowd in furniture until the foundation buckles is quite another. To have failed to solve the problem of producing goods would have been to continue man in his oldest and most grievous misfortune. But to fail to see that we have solved it and to fail to proceed thence to the next task, would be fully as tragic.¹

Accepting this as gospel, a number of influential individuals proceeded with great expectations to what they considered the next task—the formation of social programs

^{*}A speech delivered before the Leadership Ideas for Environment Forum held at the Treadway Inn, West Chester, Pennsylvania, on November 2, 1972.

¹ John Kenneth Galbraith, *The Affluent Society* (Boston: Houghton Mifflin Company, 1958), pp. 355-356.

to reduce existing "social imbalances" (poverty, deficient nutrition, and slum housing). Recently, as they became concerned over the shape of the environment, they have advocated placing additional demands on the economy with policies aimed at cleaning up the mess. Meanwhile, more consumers continue to demand more cars, more homes, and more appliances.

The tremendous expectations that blossomed from the seeds planted by Galbraith began to wither with the growing realization that the hobgoblin scarcity was alive and well. Even in a society of unparalleled wealth, desires for more social action programs, higher-quality environment, and more consumer wares outstrip the economy's ability to meet them. As these conflicting demands compete for resources, some must go unfilled. And with realization that resources are limited has come disillusionment. Many thoughtful people have turned away from the notion that growth, science, and technology, operating within the framework of a market economy, can solve our problems.

There is, I believe, an important lesson in all this: namely, that the economy cannot be the ultimate problem solver in the sense that it can generate limitless consumer goods, social action programs, and improvement in the environment. Scarcity precludes that outcome. But it is a prime problem solver in the sense that it serves as an effective *allocator* of resources among conflicting demands. By making the economy a better allocator we can help resolve many of our problems—including the "energy crisis."

THE NONGROWTH SOLUTION

The electric power industry realized its golden age of growth from the 1920s to the mid-1960s. The demand for electricity was small relative to the resources needed to meet it. At the beginning, people had few of the appliances that cooked their food and cooled their homes, not to mention those

that brushed their teeth and popped their corn. As they installed more plug-ins, the power industry had little problem supplying the juice that fuels them. Resources for generating electricity were plentiful, and their exploitation involved only a fraction of the environment. Clean air and fresh water were in large supply but the goods and services electricity made possible were not; so the latter received the higher relative value.

The first signs of trouble appeared in the late 1960s when blackouts and brownouts plagued several portions of the country during peak demands. America's appetite for power had surpassed the expectations of planners. New projections indicated that the country would be consuming more than three times as much electricity by 1990. The industry accelerated its attempt to boost long-range capacity. However, a change in values was also in the wind. Fresh air and clean water were no longer so abundant. A quality environment had become an economic good of rapidly rising value. Many fuels that were used to generate electricity were deemed too dirty for future use.

Power planners and others began scrutinizing the energy resources. "Cleaner" sources like natural gas and oil have dwindling reserves. Discoveries in Alaska have helped but are no match for expected future demands. Trillions of feet of natural gas and uncounted barrels of oil may lie beneath the United States or its waters, but these reserves are yet unproven. Moreover, exploring, tapping, and developing these sources could be expensive, requiring long lead times. Oil imports have and will continue to provide some relief, but three-quarters of the world's petroleum reserves are in the Middle East and Africa, areas not always on the best of terms with the United States.

Technology offers new energy sources such as oil from shale and breeder reactors. It also offers new methods of cleaning up that abundant old standby, coal. But developing and implementing new technology

takes times and it is the next 15 to 20 years that worry planners most.

Officials in the power industry talk about how to boost output to match the future demands of a growing economy. Some others, however, are crying out for a halt to economic growth, and electric utilities are prime targets for this nongrowth cult. The power industry has come close to symbolizing the consumeristic society—purveyors of superfluous goods and gadgets and visible sources of pollution. So it seems a simple solution to slow down economic growth and reduce the output of gadgets. We could thus curtail the demand for electric power and the consequent drain on resources and pollution of water and air.

Slowing economic growth, however, seems to me neither a viable nor warranted solution to the "energy crisis." Economic growth is necessary to provide the technological equipment, methods and national income for developing new and better sources of energy. Developing the technology to tap energy resources and make them environmentally clean is a costly and time-consuming business. The problem is to match supply and demand for existing "clean" energy sources over the next few decades in order to guarantee the economic strength and technical know-how for tapping new resource bases over the long haul. The nongrowth approach cannot do this. We will need growth to generate the estimated \$500 billion to \$1 trillion in capital needed over the next few decades for developing and implementing new techniques, and for replacing existing facilities that are heavy polluters.

OLD TOOLS FOR AN OLD PROBLEM

Perhaps the most troublesome issue in the nongrowth approach is the forsaking of science, technology, and our market-oriented economy. These seem to me the tools to use in solving the "energy crisis." Rather than discarding them we ought to look for

ways to correct them so that they can continue to build the structure we want.

In the past, the market system has served us well in resolving conflicts over scarce resources. The central force in this system, of course, is the market price. It directs the flow of resources into goods and services we value most and strikes the balance between supply and demand for the economy's output.

Balance is not being struck in the energy sector. Part of the reason for this is that one important set of prices is missing—those on environmental products. The environment in the past has been almost a costless place to dispose of the unwanted by-products of production and consumption. Consequently, it is overused by everyone from automobile owners to utility executives. Without some way of incorporating environmental costs in the production process, the economy will continue to produce "too many" material goods at the expense of environmental quality.

So if we are to strike the balance between power consumption and a quality environment, we shall have to insure that people pay the price for using the skies and waterways as dumping grounds. This would raise the cost of producing energy from fuels particularly damaging to the environment. The power industry would be encouraged to seek less damaging fuels or to apply technology to clean up their production process.

In either case, consumers of electricity would pay higher rates. These rates would tend to slow the growth in demand for power.² They would also, for example, make it economical to put more insulation in homes and offices, thereby reducing energy demands for heating and air conditioning. The same kinds of pressures would be at

² One estimate is that if the "real" price of electricity remains constant over the next 20 years, the demand for it will triple but if the "real" price increases by 50 percent, demand will increase by only 80 percent.

work as have been observed for a long time in Europe where the price of gasoline is steep. That is one reason why cars are small and designed to economize on gas consumption. My point is not that we should have more insulation or smaller cars but that our market economy is capable of inducing these kinds of changes in demand.

Moreover, business would be encouraged through changes in relative prices of energy sources to apply technological know-how to improve environmental quality. Higher prices on fossil fuels, for example, would speed not only development of alternative sources of energy, but implementation of of the technology necessary to reduce the environmental impact of the use of fossil fuel.

In short, when environmental products are priced, utility executives will find it makes cents to alter their power production in such a way that both fuel resources and the environment are conserved. And as higher costs are passed on to consumers in the form of rate increases, a point will be reached where consumers find it makes cents to conserve on power consumption.

ROLE FOR GOVERNMENT

Incentives. Government has a major role to play in resolving the pricing aspects of the energy dilemma. One method it can use to put dollar signs on environmental costs is taxation. For example, the President has already recommended a tax on sulphur oxides emitted into the atmosphere. The tax would provide an economic *incentive* for polluters to curtail the use of high-sulphur fuels. It would also provide incentive to develop and implement new methods of cleaning up high-sulphur fuels and to seek out low-pollutant substitutes.

Government could also build in some incentives on the consumption side. Required labelling of consumer appliances regarding the amount of electricity or natural gas used in their operation might encourage consumers to seek out those brands that use less

energy. Consumers could economize on utility bills and producers of appliances would have an incentive to lower the energy consumption of their appliances. While this kind of incentive may seem like small potatoes now, it would grow in importance as higher rates for electricity peeled off more of the consumer's income.

Planning. The United States has no integrated energy policy. Energy responsibilities are divided among a number of agencies that can sometimes work at cross purposes. Nor is there a single agency devoted to tapping new energy sources. With energy sources becoming increasingly interchangeable and closer competitors with each other, a single department (as recommended by President Nixon) to coordinate policy seems to make good sense.

For example, the host of special incentives, quotas and pricing arrangements within each agency may be encouraging uneconomical use of our energy resources. A sole agency could coordinate energy production, allowing market forces to play a larger role in allocating energy resources but taking corrective action when necessary for environmental reasons. In addition, a single agency could sponsor and direct technological research aimed at developing a long-term program that takes into account all aspects of the problem, such as balance of payments deficits because of oil and gas imports or national security considerations.

Equity. Who is going to pay for the rising cost of electricity? Everyone will in one way or another. We will pay with higher prices for products which are heavy users of electricity. Interest rates may rise as power companies dip into the capital market to expand and improve facilities. And we will pay directly in the form of higher utility bills. Government action may be necessary to insure that the burden of higher prices is spread equitably.

For example, some have argued that low-income families spend a larger portion

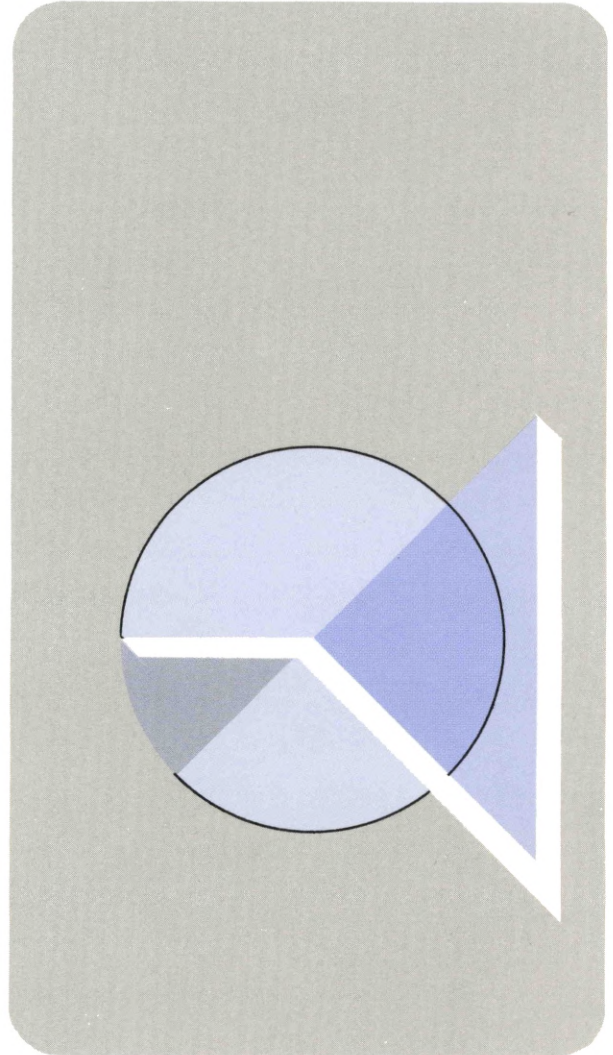
of their income on electricity than higher-income families. They see higher rates hitting these families harder, just as a sales tax on other necessities does. If this is the case, government could lessen the burden on the poor by altering the rate structure so that those who consume relatively small amounts of electricity pay a lower rate than those who consume larger amounts. This could mean that large industrial users would have to pay higher rates as opposed to the declining block rates that many now pay.

CRISIS?

A real danger—and perhaps the real “crisis”—in the energy issue is that there

will be a turning away from the economy in seeking solutions. Many will be tempted to do this as they confront continuing environmental problems, social disparities, and the shattering reality that the economy cannot, after all, give us everything we might like to have. The energy problem confronting us is essentially economic, and the market economy is a reliable tool for solving it. The non-growth route is not. If we improve the operation of the economy rather than forsake it, we can speed technological development, stretch energy resources, and have a cleaner environment, all within the context of growth. ■

Household Savings at Commercial Banks: Bigger Slice of a Bigger Pie

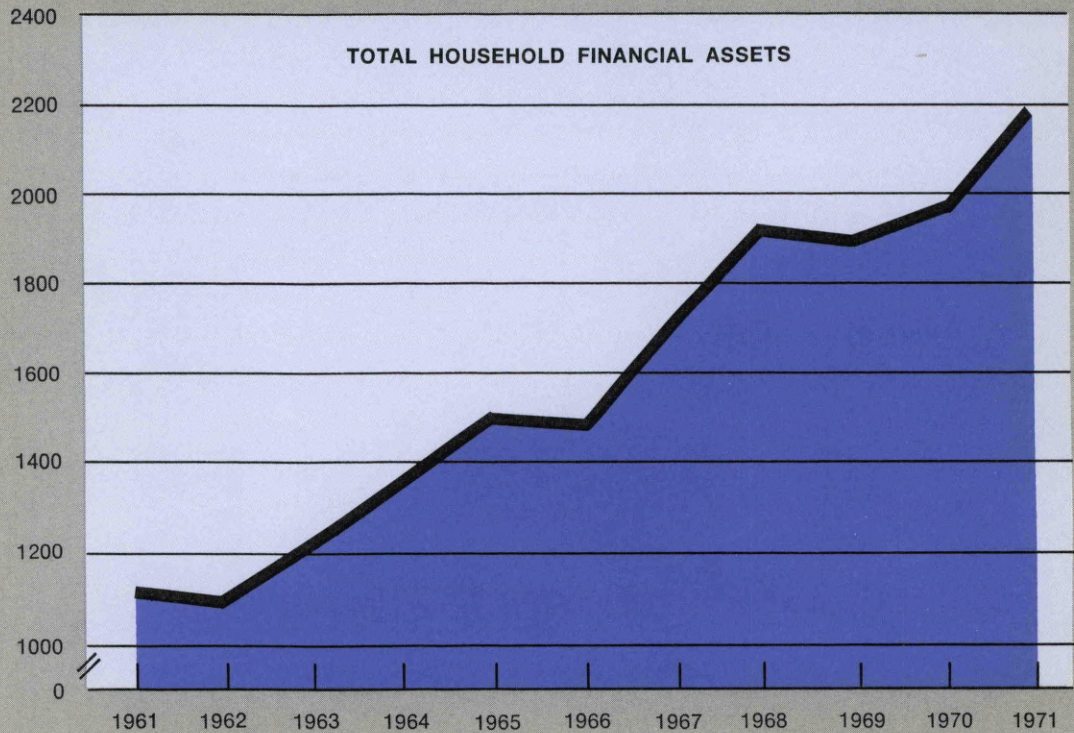


By Howard Keen, Jr.

CHART 1

HOUSEHOLD FINANCIAL ASSETS HAVE ALMOST DOUBLED SINCE 1961 . . .

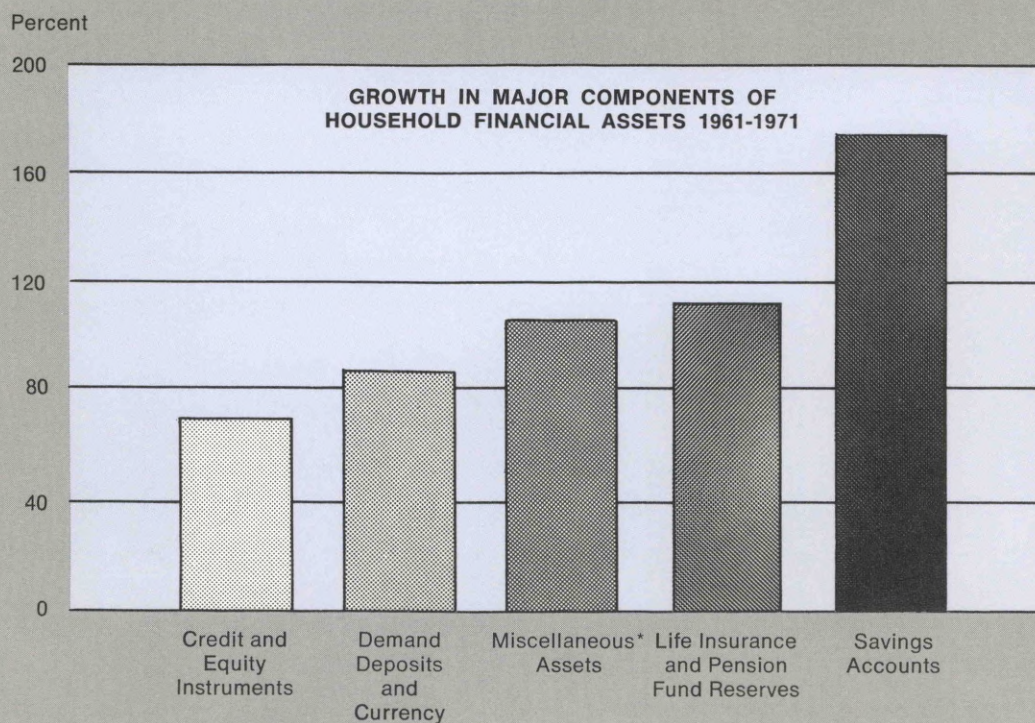
Billions of Dollars



Source: Federal Reserve Bulletin Flow of Funds

CHART 2

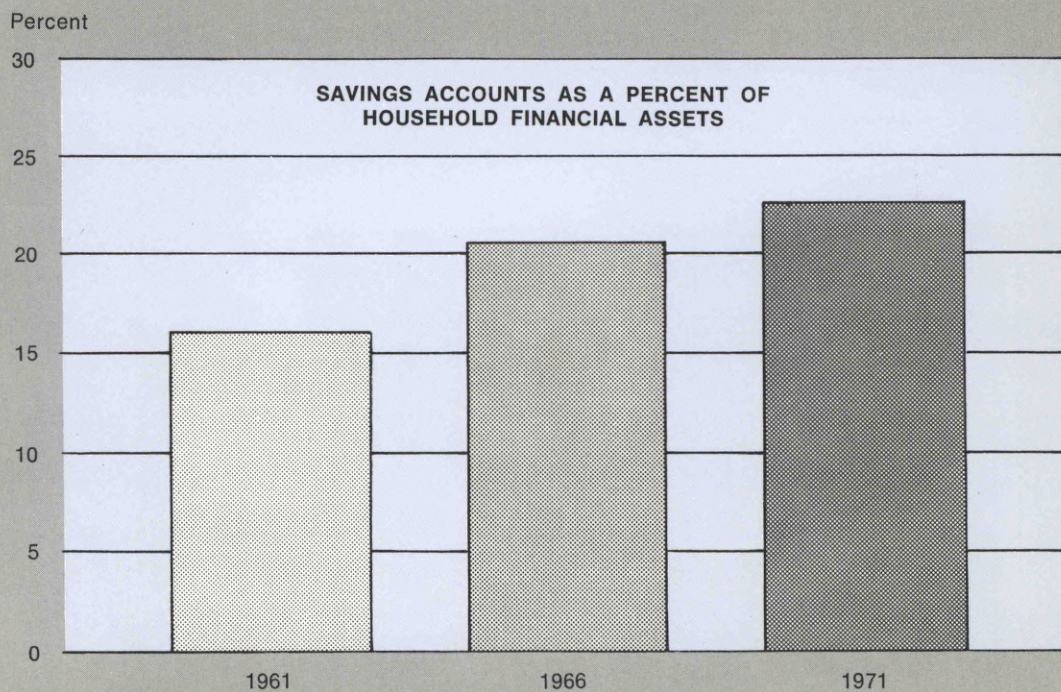
WITH SAVINGS ACCOUNTS EXHIBITING THE FASTEST GROWTH . . .



Source: Federal Reserve Bulletin Flow of Funds

CHART 3

SO THAT TODAY, SAVINGS ACCOUNTS REPRESENT ALMOST ONE OUT OF EVERY FOUR DOLLARS OF HOUSEHOLD FINANCIAL ASSETS.

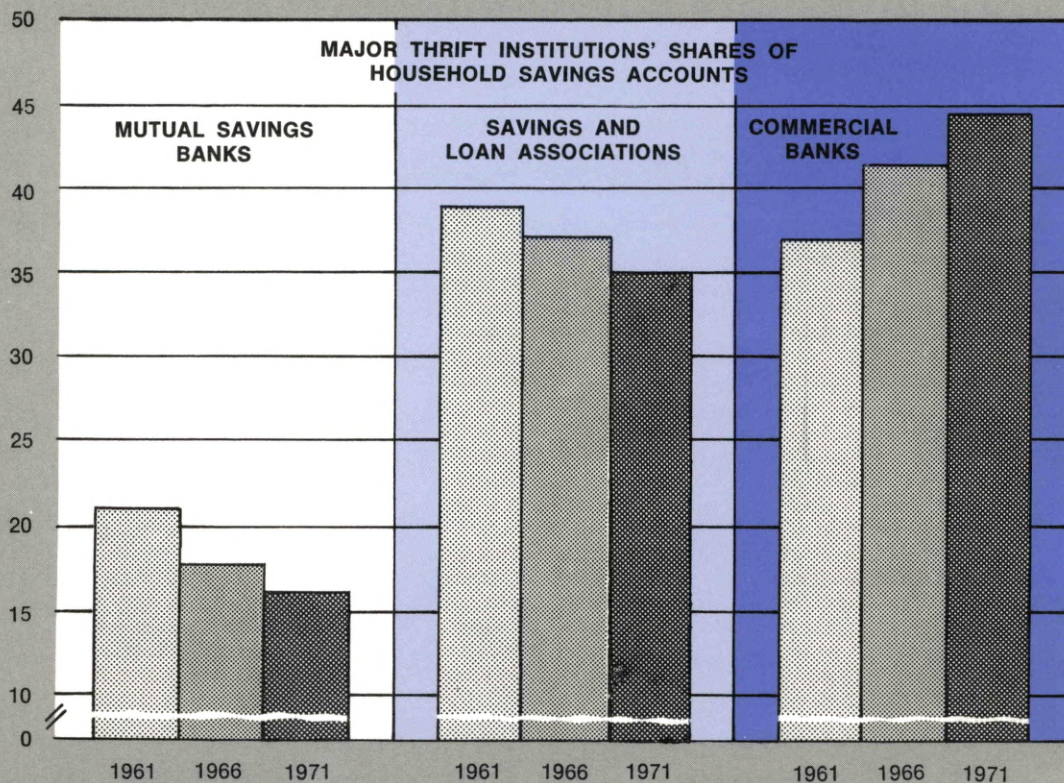


Source: Federal Reserve Bulletin Flow of Funds

CHART 4

COMMERCIAL BANKS HAVE INCREASED THEIR SHARE AT THE EXPENSE OF MUTUAL SAVINGS BANKS AND SAVINGS AND LOAN ASSOCIATIONS . . .

Percent

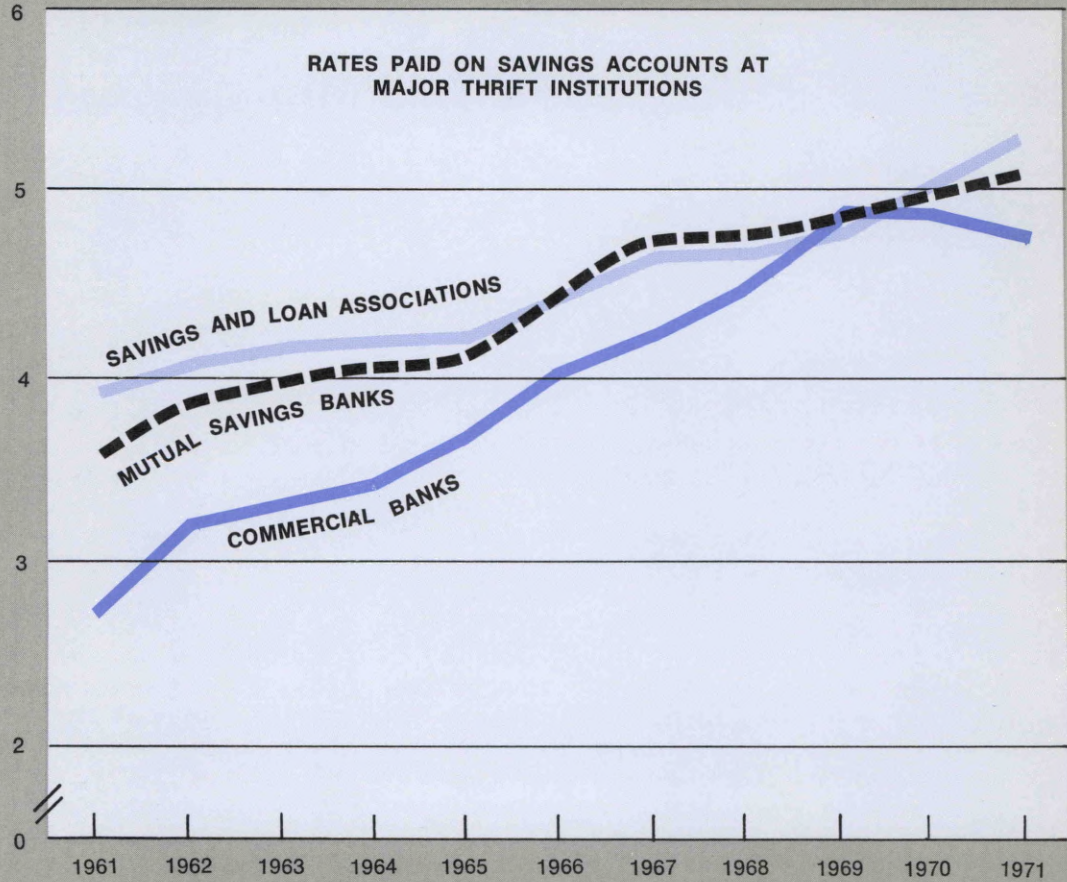


Source: Federal Reserve Bulletin Flow of Funds

CHART 5

IN PART, BECAUSE THEY HAVE NARROWED THE GAP IN RATES PAID TO SAVERS.

Percent



Source: Savings and Loan Fact Book

Does Banking Structure Spur Economic Growth?

By Jerome C. Darnell

This article examines the impact of banking structure on economic growth throughout the nation. A forthcoming issue of the *Business Review* will focus on banking in Pennsylvania, specifically analyzing the relationship of banking structure to competition, performance, and economic growth.

Like Old Faithful, a debate has been boiling for years over which type of banking structure, branch or unit, yields the larger economic growth dividend. Each side presents its case by citing a state that combines high economic growth and a particular type of banking structure as proof that the structure caused the high growth. States with the same organizational style but with low growth are often conveniently overlooked.

This is a timely issue because a number of states, Pennsylvania included, are reviewing their state laws governing the establishment and location of branch banks. Many bank-structure watchers see an easily detectable

link between style of banking structure and economic performance, and they often contend "archaic" banking laws stifle growth. The conventional wisdom is that wider branch banking can propel a state's economy at a faster clip. And certainly the trend over the decades has been unrelenting toward wider branching. In accepting this belief, many analysts have argued that relaxation of restrictive branching laws will unleash the economic forces so that a lagging state can soon make some "great leap forward." However, close comparison of frequently cited indicators of statewide economic performance may tend to shake one's faith in this doctrine.

THE PROCESS OF ECONOMIC GROWTH

Achieving economic growth is not a matter that can be easily turned on and off like a water faucet.¹ In an enterprise economy such as ours, commercial banks, along with other members of the financial infrastructure, fill a key slot in generating growth. Banks serve as collectors of savings and are instrumental in the money-creating process. They help decide who gets loanable funds, thereby helping to channel growth into certain industries and localities. Their presence alone, however, is not enough to boost growth.

Other elements constituting the resource base must be present and interacting to produce growth. Research, skilled labor, natural resources, transportation networks, new products and a market for them, a spirit of entrepreneurship—all these are needed. But a fundamental requirement for growth is capital formation erected from the elements that form the resource base.

For capital formation to materialize, a part of current income must be saved and plowed back into income-generating investments, thereby helping expand the capital base even more. Once started, it tends to become a self-perpetuating cycle. Additions to the capital stock cannot take place unless saving has occurred or is taking place. However, saving is unproductive until it is converted into some income-generating process through investment. The process of converting saving into income-producing capital is where banks make their major contribution.²

¹ For a discussion of regional growth, see James L. Freund, "Regional Growth: The Whys and Wherefores," *Business Review of the Federal Reserve Bank of Philadelphia*, October 1972, pp. 18-26.

² Large banks, both branch and unit, probably do a better job than small banks of converting savings into capital formation and sparking economic growth if their traditionally higher loan-to-deposit ratios are any valid criterion. From this premise it is frequently argued that wider branching spurs capital formation because this type of organization facilitates the growth and

However, before banks can accelerate the tempo of their region's growth (when it is an integral part of a national economy), two important conditions are necessary: The flow of investment funds must be increased and a leading growth sector must emerge.³

Larger Pool of Investment Funds. More investment funds become available if the saving rate in the state rises and leakage of funds to neighboring states is arrested. But if gains in the saving rate are tied to income levels and to rates of income growth, as many economists argue, then the banking system may have only limited ability to enlarge the investment pool.

For example, in branching states banks can follow customers to the suburbs and make services more accessible through strategic office locations. A similar method is used in nonbranching states by chartering new banks in the outlying communities. Banks can pay the maximum interest rates to attract deposits, although all banks, regardless of organization or location, are constrained by the same ceiling rates on time deposits. Advertising campaigns encouraging customers to use bank services more intensively might influence the level of saving in a community, but usually only account switching results.

Is it reasonable to expect these efforts to alter significantly the consumption and thrift habits of the banking public so that the level of saving is noticeably lifted?

development of larger banks. (Most large banks are in branching states.)

Opponents of branching retort that wider branching leads to greater concentration of banking resources, which is usually true at the statewide level. If increases in statewide concentration or maintenance of previous high levels of concentration act to stifle competition, economic growth could be retarded by wider branching.

³ Hyman P. Minsky, "Commercial Banking and Rapid Economic Growth in California," Hyman P. Minsky, ed., *California Banking in a Growing Economy: 1946-1975* (Berkeley: Institute of Business and Economic Research, University of California, 1965), p. 80.

Probably not. It is equally hard to believe that branch or unit banking would have any measurable impact on the size of the investment pool.

Leading Growth Sector. The other method of acquiring more investment funds is capital importation. A state's ability to attract outside capital depends on the second condition essential for faster growth—a leading sector, like the boom in Florida tourism associated with Walt Disney World. If one or more sectors start outstripping the rest of the national economy, then investors will soon recognize that actual and potential returns are better here than in alternative locations and uses. If these investment opportunities emerge, funds will usually flow into a state and fuel its economic growth. Because of well-developed capital markets and the relative ease of interregional capital flows, no state's or region's growth need be shackled by its lack of indigenous saving or type of banking structure. However, it is possible that a stultifying banking climate could slow those growth sectors whose time has come.⁴

DOES BANK STRUCTURE INFLUENCE BUSINESS LOCATION OR ACCESS TO FUNDS?

When business firms contemplate new plants or new locations, their decisions hinge on various economic and social conditions. Size and location of the market to be served, supply and training of the work force, natural resources, access to raw materials, transportation facilities, local tax rates, and the cultural-social environment—these conditions usually figure more heavily than

banking structure when a firm considers a location. Banks, whether branch or unit, cannot overcome deficiencies in these fundamental ingredients. Furthermore, new firms are always opening and old ones closing, and the statistics bear no relation to state banking structure.

If a business firm expects to expand, it must be able to secure permanent types of financing. Generally, the banking system does not provide long-term investment funds. Financing for plant and equipment depends on tapping long-term debt and equity sources. Banks specialize in short- and intermediate-term credit.

Through the years a number of private, semiprivate, and government credit sources have emerged to supplement the long-term financing needs of business firms, reducing even more their dependence on local banks. Furthermore, corporations on the average have used internal sources of funds for around 60 percent of their financing. To the extent that business firms rely on outside financing, bank loans usually have not accounted for more than a tenth of total external credit.

While it appears that style of banking organization may not be very crucial in determining where a firm builds its plant or how it gets expansion capital, the banking system plays an important *supportive* role in stoking the economic furnace and in grating the coals. Banks provide support by collecting savings, allocating credit, and creating money. In all probability, however, the *attitudes of individual bank managers* are more critical in performing these functions than organizational features. But even in performing these functions, banks cannot operate as free-wheelers because of the constraints imposed on them by the money and credit policies of the Federal Reserve System.

Federal Reserve policy aims to eliminate wide swings in economic activity so that the monetary and credit environment is conducive to the saving-investment process. To

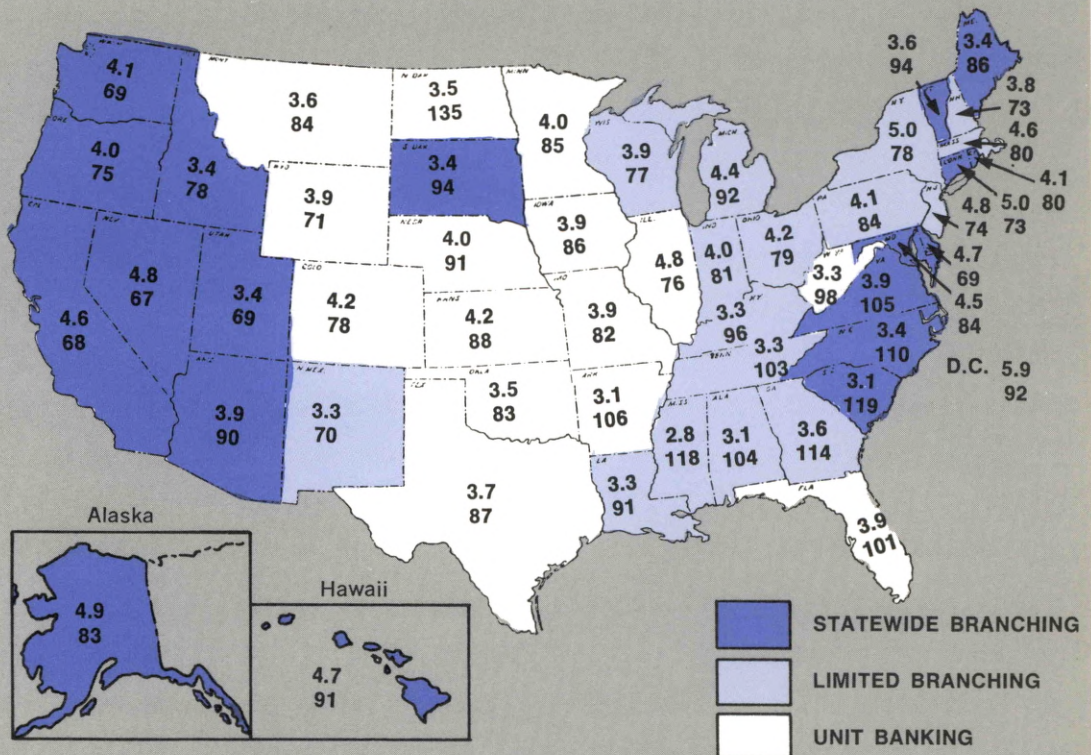
⁴ One economist has suggested that the chief contribution to more rapid economic growth from a banking network with dynamic management and adequate growth rate centers not around the role of banks in abetting the import of capital. Their contribution arises as a source of financing for those enterprises producing nontransportable goods and services. These firms typically cannot tap national credit markets, but their development is nevertheless essential for rapid growth of the local economy. *Ibid.*, p. 101.

be sure, Federal Reserve policy may have differential regional impact and differential impact on large as opposed to small banks. Nevertheless, national policy sets the tone for capital formation. Consequently, it would appear that any edge one type of banking structure might hold over another in attracting capital imports and enhancing saving probably plays a minuscule role to national policy in capital formation and economic growth.

SOME COMMON MEASURES OF ECONOMIC GROWTH

The relationship between a state's bank structure and its pace of economic development cannot be pinpointed. Perhaps that is why no thoroughgoing analysis of the subject has been undertaken. However, some notion can still be gained of how one type of structure stacks up against another by comparing a few broad indicators of economic growth. It is readily acknowledged that

STATEWIDE BRANCH BANKING PREDOMINATES IN THE WEST AND ON EAST COAST; UNIT BANKING PREVAILS FROM THE MISSISSIPPI TO THE ROCKIES



Note: Top Figure — Per Capita Personal Income (\$000) in 1971
Bottom Figure — Percentage Change in PCPI 1961-1971

Changes in branching classifications of states since 1960 are as follows: South Dakota from unit banking to statewide branching; Virginia and Maine from limited to statewide branching; New Hampshire and Wisconsin from unit banking to limited branching.

examining only a few measures over a short span will not provide the in-depth treatment essential for settling the debate over which type of banking structure yields the larger growth dividend. Nevertheless, it is helpful to have some overall impressions about what has been happening recently among the various states.

The ideal measure of economic growth for each state would probably be its real gross product—the market value of all goods and services produced in a state over a specific time period and corrected for price level changes. Estimates of this nature are not available, so we must rely upon other measures like personal income, population, and nonagricultural employment. Deposit growth and loan-to-deposit ratios can also be used to give some idea about the growth and performance of a state's banking system.

The map has states classified according to statewide branching, limited branching, and unit banking. It also includes 1971 per capita personal income and percentage change in per capita personal income between 1961 and 1971. Charts 1 to 6 present the average of several economic and banking indicators for all states included in each type of banking structure. Nineteen states and the District of Columbia fall into the statewide branching camp. The limited branching group is composed of 16 states, and 15 states constitute the unit banking group.

WHAT DO THE MEASURES SAY ABOUT BANKING AND GROWTH?

The charts show that a number of differences exist among the states comprising the three types of banking structure. But are these variations great enough to allow sound judgments about the relationship between banking structure and economic performance?

The differences are considered *statistically significant* when there is only a small probability, say five times out of 100, that they could arise because of chance or random

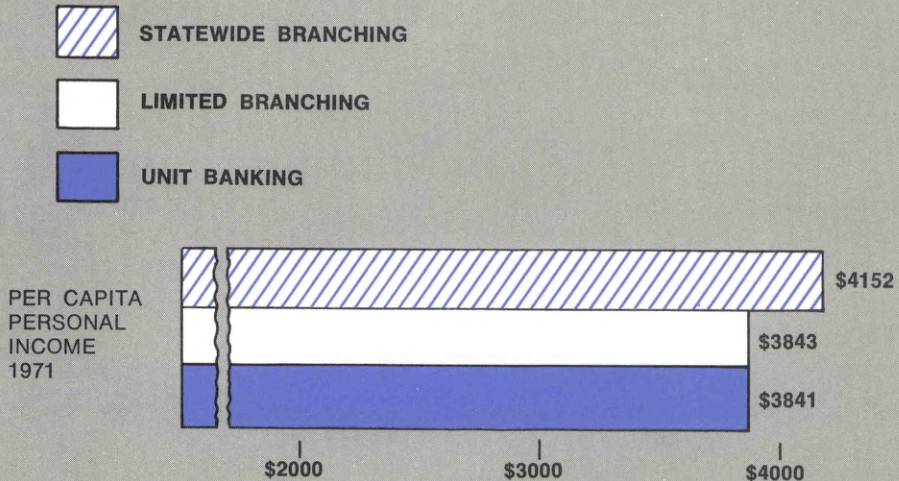
influences. A finding of statistical significance, however, does not necessarily mean a cause-and-effect relationship. If the differences are *statistically insignificant*, the values observed for the variable are not systematically associated with banking structure classes. In other words, the range of values observed *within* a particular grouping overshadow the differences noted *between* the groupings.

Therefore, the charts should be studied carefully to avoid faulty inferences. For example, Chart 1 shows 1971 per capita personal income averaged about \$300 more in statewide branching states compared with limited branching and unit banking states. But the range of per capita personal income values was so great *within* each bank structure class that differences *between* the classes were *statistically insignificant*. Likewise, percentage changes in total personal income, per capita personal income, and median family income during the '60s were *not* statistically significant. Each measure favored a different group of states.

Much of the explanation for higher levels of per capita personal income in a number of the statewide branching states is that they are more heavily "industrialized." However, after achieving higher industrialization and higher income levels, it becomes increasingly difficult to keep incomes growing at a fast pace. Thus, in recent years the most noticeable gains in per capita personal income have been in the Southeast mainly because of that region's lower level of industrialization. Nine of the top 10 states in per capita personal income growth are in the Southeast (North Dakota is the exception). As an example of the industrialization underway, manufacturing jobs in the Southeast rose nearly 45 percent in the past decade compared with only 15 percent for the nation. It would be hazardous to conclude that banking structure was pivotal in garnering these jobs since all three types of banking structure are represented in the Southeast.

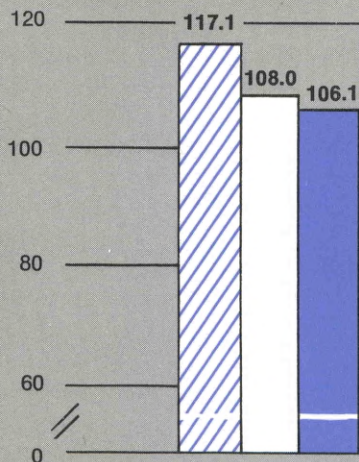
CHART 1

AVERAGE LEVEL OF PER CAPITA PERSONAL INCOME IS \$300 HIGHER IN STATE-WIDE BRANCHING STATES.



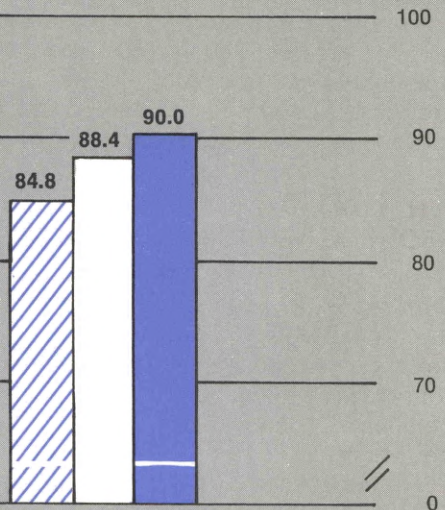
AVERAGE GAINS IN TOTAL PERSONAL INCOME WERE HIGHEST IN STATEWIDE BRANCHING STATES—LOWEST IN UNIT BANKING STATES.

Percent Increase 1961-1971



AVERAGE GAINS IN PER CAPITA PERSONAL INCOME WERE HIGHEST IN UNIT BANKING STATES—LOWEST IN STATEWIDE BRANCHING STATES.

Percent Increase 1961-1971



Population growth (Chart 3) was one of just two indicators examined that showed statistically significant differences among the banking structure classes. Substantially faster population growth was achieved in statewide branching states. (This is the primary reason that, despite slightly higher total personal income growth, per capita personal income gains were lowest in the statewide branching states.)

Population growth alone is a poor indicator of economic growth. However, taking the view that people presumably go where employment opportunities are better, it can be considered a good indirect measure of economic growth. To the extent that migrations include retired workers, or reflect attempts to live in more desirable climates and physical surroundings but not necessarily better job markets, then population change is a dubious growth measure. Despite these shortcomings, it is generally felt that a state attracts more people because it experiences above average economic growth and should have more employment opportunities. Moreover, availability of labor is an essential ingredient for economic growth.

Change in nonagricultural employment is another common indicator of economic growth (see Chart 4). As an earmark of a more industrialized state, higher income growth should be accompanied by higher rates of growth in nonagricultural employment. The figures are fairly consistent in this regard because a ranking of states according to gains in nonagricultural employment and gains in per capita personal income during the '60s reveals some positive correlation.

Once again, caution should be used in focusing attention on total nonagricultural employment, because this figure gives no indication of the mix between manufacturing and nonmanufacturing employment. Although statewide branching states led in adding more workers to their payrolls, closer examination indicates that most gains were in

the nonmanufacturing and service industries where incomes are likely to rise more slowly. Conversely, a sizeable number of unit banking and limited branching states, especially in the Southeast, posted heftier gains in manufacturing workers—hence, their better record on per capita personal income gains.

The growth of commercial bank deposits should correspond to the growth of personal incomes. Ordinarily a high measure of association can be found between a state's percentage share of total commercial bank deposits in the country and its percentage share of total personal income. Differences in total personal income growth were not systematically related to banking structure so, not surprisingly, the differences in deposit growth rates are statistically insignificant (see Chart 5).

The loan-to-deposit ratio is often taken as a rough rule of thumb for judging how banks use the funds at their disposal. It is generally believed that higher loan-to-deposit ratios indicate high loan demand coming from a growth area, and banks in turn fuel the local economy when fulfilling these demands. Thus, it is argued that higher loan-to-deposit ratios are most likely associated with areas experiencing faster economic growth.

The loan-to-deposit ratio differs significantly among the state groups and favors the states allowing more widespread branching systems (see Chart 6). But, statistical tests show no orderly relationship between income measures and the ratios. This suggests that other factors should be considered when probing for the cause of the higher ratios and appraising contribution to economic growth.

Part of the explanation for higher loan-to-deposit ratios may be that states with wider branching rules have a high number of the nation's largest banks since branching fosters the development of big banks. Five out of six banks with over \$500 million in deposits are in branching states. Moreover,

CHART 2

MEDIAN FAMILY INCOME GROWTH FAVORED LIMITED BRANCHING STATES.

Percent Increase 1961-1971

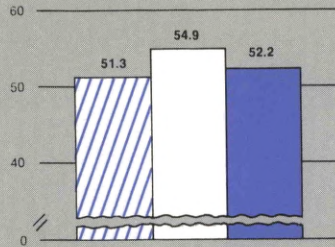


CHART 3

AVERAGE POPULATION CHANGES WERE TWICE AS HIGH IN THE STATEWIDE BRANCHING STATES.*

Percent Increase 1961-1971

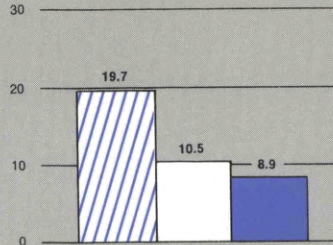


CHART 4

STATEWIDE BRANCHING STATES HAD AN EDGE IN NONAGRICULTURAL EMPLOYMENT GAINS.

Percent Increase 1961-1971

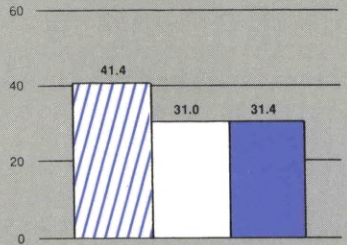


CHART 5

DEPOSIT GROWTH WAS NECK-AND-NECK IN STATEWIDE AND LIMITED BRANCHING STATES, A FEW PACES AHEAD OF UNIT BANKING STATES.

Percent Increase 1961-1971

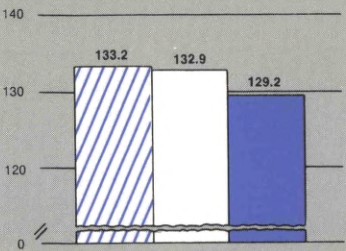
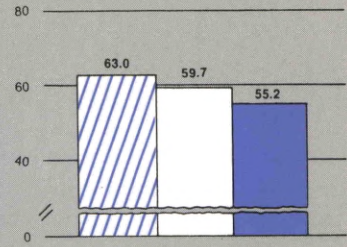


CHART 6

LOAN-TO-DEPOSIT RATIOS AT COMMERCIAL BANKS WERE SIGNIFICANTLY HIGHER IN THE BRANCHING STATES.*

Percentage 1971



STATEWIDE BRANCHING



LIMITED BRANCHING



UNIT BANKING

* Statistical tests indicate differences are significant.

banking resources in these states are more heavily concentrated in the hands of a few large banks.

Larger banks usually have higher loan-to-deposit ratios. The reasons for this are easy to find. One is that large banks supply loans in a national market. This enables them to achieve more diversification in their loan portfolio, thereby reducing the risk. Large banks are not tied as closely to local loan demand because of their active national solicitation. Smaller banks are more likely to wait for customers to walk in the door.

Large banks can weather losses more readily, so they are inclined to push their loan business more aggressively. Also, large banks can employ experts in a greater variety of industries, providing additional opportunities for a more diversified stable of loans.

Thus, a bank's size is more important than its organizational structure in accounting for higher loan-to-deposit ratios. All large banks, say above \$500 million in deposits and with other things about equal, will operate with fairly comparable high loan-to-deposit ratios regardless of whether they are in branch or unit banking states.

Moreover, care should be taken in drawing inferences about the contribution of the loan-to-deposit ratio to local economic growth. A high ratio gives no information about the geographical distribution of borrowers. It is especially true that loans of a large bank may be going to out-of-state borrowers, serving to nourish the economy of some region other than where the bank is physically located.

In short, the kinship of structure and growth is too weak to support change in the banking law in the belief that higher levels of economic growth can be reached. And the likelihood of any perceptible impact on growth dwindles when the state involved is one like Pennsylvania, already more highly industrialized than most other states.

DOES BANKING STRUCTURE MAKE ANY DIFFERENCE?

Examination of the most common indicators of economic performance does not reveal any systematic or readily discernible relationship between a state's style of banking structure and its tempo of economic growth. Some measures of economic growth and banking performance tend to favor states with statewide branching while other measures lean toward unit and limited branching states. *Only population growth and loan-to-deposit ratios were found to be systematically associated with bank structure classes.* However, the general absence of findings showing a firm structure-growth linkage should not be taken as evidence denying a cause-and-effect relationship. Such kinship may exist. The absence of any observable connection may be only because of the lack of precise tools for measuring the relationship.

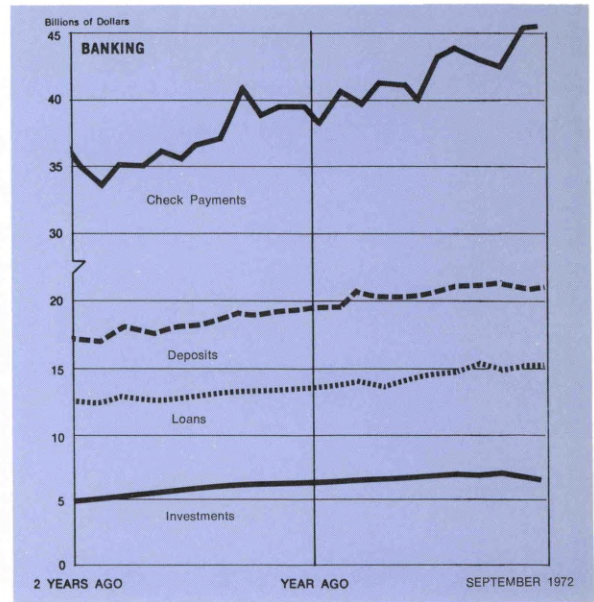
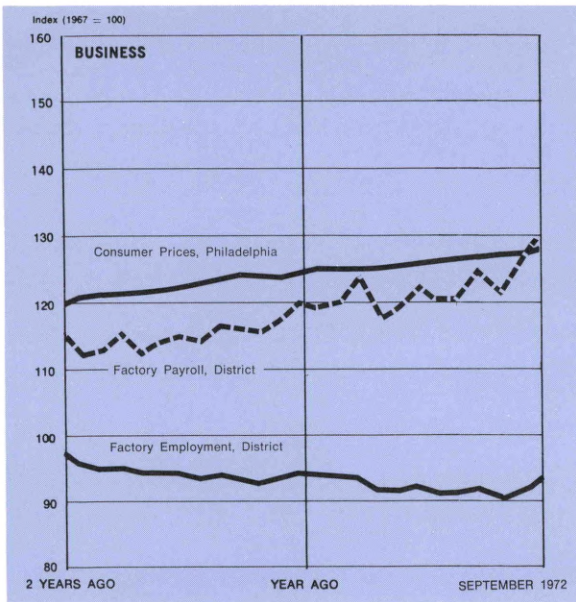
Although the indicators of economic growth reflect no clear advantage for one type of banking structure over another in terms of statewide economic performance, it should not be inferred that banking structure is insignificant in terms of *intrastate*

development. More than likely there are many local areas where banks could be more aggressive in boosting their economy. Many individuals and small businesses may be hampered in obtaining credit outside the local community. Their credit needs would no doubt be served better by a more competitive local banking climate.

One of the main advantages of new entrants into these local markets is to stimulate the local economy by providing an alternative banking source. The competitive atmosphere in local areas may be improved substantially as a result of a reshuffling in banking structure. Perhaps the real issue revolves around the type of banking structure most likely to foster maximum competition by opening the gates to newcomers. At any rate, caution should be exercised in interpreting measures of statewide economic performance since a great deal of public benefit generated by a competitive, dynamic banking climate in local communities may be masked when we concentrate only on the aggregated statewide figures.

The process of attaining economic growth contains few useful clues for believing one type of banking structure is more likely to spur growth than others. The size of the economic growth dividend for a state or region hinges on a host of factors forming the economic resource base. Each state is unique, and banks, regardless of organizational form, cannot offset shortcomings in those elements vital for capital formation. Thus, changes in the banking law may be desirable for various reasons, such as spurring competition or providing for the flexibility needed to meet a rapidly changing financial environment. But the prospects of consciously legislating higher economic growth statewide by altering the banking codes are slim. If and when growth comes, it results mainly from other forces at work. Growth does not appear to be closely linked to a particular style of banking organization. ■

FOR THE RECORD...



SUMMARY	Third Federal Reserve District			United States		
	Percent change			Percent change		
	Sept. 1972 from		9 mos. 1972 from	Sept. 1972 from		9 mos. 1972 from
	mo. ago	year ago	year ago	mo. ago	year ago	year ago
MANUFACTURING						
Production.....	.....	.....	.....	+ 4	+ 9	+ 7
Electric power consumed ...	+ 2	+ 6	+ 3	.....	.....	.....
Man-hours, total*.....	+ 1	+ 1	- 1	+ 2	+ 6	N/A
Employment, total.....	+ 2	- 1	- 3	+ 1	+ 3	+ 2
Wage income*.....	+ 2	+ 8	+ 5	+ 3	+14	N/A
CONSTRUCTION**.....	-13	+23	-16	- 8	+23	+15
COAL PRODUCTION.....	+ 3	- 6	- 6	+ 3	- 6	- 6
BANKING (All member banks)						
Deposits.....	+ 2	+14	+13	+ 2	+10	+10
Loans.....	+ 1	+16	+14	+ 2	+14	+13
Investments.....	+ 1	+ 9	+13	+ 1	+ 9	+ 9
U.S. Govt. securities.....	+ 1	0	0	+ 2	+ 3	+ 1
Other.....	+ 1	+13	+20	+ 1	+12	+14
Check payments***.....	- 2†	+14†	+15†	0	+15	+14
PRICES						
Wholesale.....	.....	.....	.....	0	+ 5	+ 4
Consumer.....	+ 1†	+ 3†	+ 3†	0	+ 3	+ 3

*Production workers only
 **Value of contracts
 ***Adjusted for seasonal variation

†15 SMSA's
 ‡Philadelphia

LOCAL CHANGES Standard Metropolitan Statistical Areas*	Manufacturing				Banking			
	Employment		Payrolls		Check Payments**		Total Deposits***	
	Percent change Sept. 1972 from		Percent change Sept. 1972 from		Percent change Sept. 1972 from		Percent change Sept. 1972 from	
	month ago	year ago	month ago	year ago	month ago	year ago	month ago	year ago
Wilmington.....	0	+ 1	+ 9	+ 6	+ 8	+22	+ 3	+ 7
Atlantic City.....	- 3	+ 2	-10	+ 7	+ 2	+18	0	+21
Bridgeton.....	- 2	- 1	N/A	N/A	N/A	N/A	+ 2	N/A
Trenton.....	+ 2	+ 5	+ 5	+24	-16	+13	- 1	+11
Altoona.....	- 2	- 5	0	+ 7	+13	+22	0	+12
Harrisburg.....	+ 1	- 2	0	+10	+ 6	+30	+ 3	+18
Johnstown.....	- 2	+10	+ 1	+24	+ 6	+16	+ 1	+11
Lancaster.....	0	+ 2	+ 1	+16	- 4	+48	+ 2	+17
Lehigh Valley.....	0	- 1	+ 1	+12	+ 3	+16	+ 2	+17
Philadelphia.....	0	- 1	+ 1	+ 6	- 4	+10	+ 2	+13
Reading.....	- 4	- 3	- 1	+10	+ 3	+ 4	- 5	+10
Scranton.....	0	- 2	+ 3	+ 6	+ 2	+10	0	+12
Wilkes-Barre.....	0	- 3	+ 1	+ 7	+ 5	+28	+ 5	+28
Williamsport.....	N/A	N/A	N/A	N/A	- 1	+16	+ 3	N/A
York.....	0	+ 1	0	+ 7	+13	+54	+ 2	+12

*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.



**FEDERAL RESERVE BANK of PHILADELPHIA
PHILADELPHIA, PENNSYLVANIA 19101**

business review

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PHILADELPHIA, PA. 19101**

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