

# BUSINESS REVIEW

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Federal Reserve Bank of Philadelphia

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## OUR VANISHING GOLDEN AGE?



Also:  
Potential Competition  
and the Banks  
&  
The Fed in Print

JANUARY/FEBRUARY 1978

# BUSINESS REVIEW

**Federal Reserve Bank of Philadelphia**  
100 North Sixth Street  
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Philadelphia, Pennsylvania 19106

## OUR VANISHING GOLDEN AGE?

*David P. Eastburn*

. . . After 30 years of rapid economic growth, the industrialized world faces a shrinking resource base. But intelligent action still can avert an end to this golden age, the author says.

## POTENTIAL COMPETITION AND THE BANKS

*Timothy Hannan*

. . . The mere threat that a new institution will enter a local banking market can produce effects much like those of actual competition.

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## Our Vanishing Golden Age?\*

*By David P. Eastburn, President  
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I've just returned from a short stay in Greece where I had an opportunity to examine the remains of classical Greek civilization. Much of it was the product of a relatively brief frenzy of activity around 450 B. C. when Pericles was in power. This was a golden age for Greece. It was remarkable in its time, but it has passed.

Perhaps this has influenced my choice of a theme this evening. A number of percipient analysts of our current civilization are saying that we have seen a golden age in the past 30-odd years and that this age is vanishing. I want to examine this idea, what's behind it,

and what it implies for the future.

### THE GOLDEN GENERATION

A generation is roughly 30 years. If you were born 30 years ago—as many of you here were—you would have lived through a remarkable era. Let me give you a few facts.

First off, there has been a substantial change in how much we earn. A family now has about twice the purchasing power—even after allowing for inflation—of a family at the end of World War II. A typical worker in 1947 had to work almost nine months to earn enough for a car; today, he can earn enough in less than five months. And because of these rising incomes, the total real wealth per person has quadrupled.

There has been a tremendous leap in health, education, and housing. We now can transplant organs as complicated as the heart,

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\*Remarks delivered before the Saint Joseph's College Alumni Accounting Association, Bala Cynwyd, Pennsylvania, November 3, 1977. The views expressed are mine and do not necessarily reflect those of my colleagues in the Federal Reserve System.

kidney, and parts of the eye. A shattered knee can be replaced with an artificial joint, and the threat of polio has been all but eliminated. A child born today can expect to live about 15 percent longer than his counterpart of 30 years ago, and his chances of surviving the ordeal of birth are about 50 percent greater.

We are better educated. The proportion of the population over 25 years old with four or more years of college has jumped by 50 percent. And the typical American now has better than 12 years of schooling compared to 9 years three decades ago.

What we live in has also changed dramatically. Nearly half the population lived in dilapidated or substandard housing at the end of World War II. Today, only 7 percent of the population lives in such a fashion. Two-thirds of us now own our homes; 30 years ago the majority rented. And our homes are filled with TV sets, air conditioners, and dishwashers that were rare or nonexistent a few decades back.

But perhaps the most striking and far-reaching developments have occurred in technology, science, and information. We have the computer. Today, business—including accounting—simply could not function without the computer. It has allowed us to analyze the burgeoning information flow with a speed and accuracy unimaginable a generation ago. It played a major role in putting men on the moon and is crucial in our satellite communications network. In short, it has greatly accelerated the spread and implementation of new technology.

We take jet travel, atomic and nuclear energy, television, satellite communication, and space shots for granted, yet none of these was a part of the world 30 years ago. Moreover, the rate at which new technology is being implemented is estimated to be some 70-80 percent faster than it was prior to World War II.

So we have become healthier and wealthier, if not wiser, at an astounding rate during the past three decades. This explosion of tech-

nology and material well-being seems to outstrip by far that of any other period. Many students of progress do label it a golden age.

All this is not to say that the past 30 years have been sweetness and light. They have seen troubles aplenty—the Korean and Vietnam wars, race riots, generational conflicts, breakdown of our cities, Watergate, a major recession, and frightening inflation. So, if it is true that we have been living through a golden age, it is gold with a good bit of tarnish. And, some say, it contains the seed of its own destruction; the golden age will be vanishing during the rest of the century.

They see two possible scenarios. One we might call the Mother Hubbard scenario, the other the Gone Fishin' scenario. Let's look at each of these briefly.

### MOTHER HUBBARD

Will we go to the cupboard and find it bare? Certainly, we have been using up resources at a furious pace during the golden years. It would hardly have been possible to produce as much as we have, to have improved our material well-being so greatly, without using up vast quantities of resources. And it is true that we have been so preoccupied with our affluence that we have given little thought to the resource base.

In less than two decades, however, we have refocused our concern from Galbraith's *Affluent Society* to the Club of Rome's *Limits to Growth*.<sup>1</sup> Now geologists, agronomists, and physicists are at center stage. Whether we will have sufficient basic resources to sustain and expand life as we have come to know it depends to a considerable extent on what they have to say.

But it also depends on what economists have to say. I can't speak for the scientists. I

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<sup>1</sup>John Kenneth Galbraith, *The Affluent Society* (Boston: Houghton Mifflin Company, 1958); *The Limits to Growth: A Report for the Club of Rome's Project on the Predicament of Mankind* (New York: Universe Books, 1972).

don't propose to examine the geology of petroleum deposits, the technology of solar energy, or the chemistry of the Green Revolution. But I would like to say a word about the economics of the resources problem.

Start with the reality that resources are limited. There is just so much oil, coal, and iron in the ground; there is just so much cultivatable land. At some point on this collision course the collision happens; rising demands on resources run into the limit of resources. Nobody really knows when. Alarmists see it happening soon enough that we must immediately begin slowing growth. Others—including myself—see good possibilities for the economy to work out a solution, at least within the time period most of us can foresee and care about.

Whether the economy actually can do this depends on whether we let it do it. Congress right now is in the throes of deciding how to deal with energy. Advocates of a flexible price system say we have the solution built into our economy. When there is more demand for something than supply will support, its price will go up. This induces some to cut back on their demand and stimulates others to increase supply. As resources eventually begin to run out, prices not only will ration what's left but will induce some producers to find alternative ways of meeting the demands. In the case of oil, for example, rising prices will cut back on gasoline consumption by car drivers and encourage producers to sink new wells. As we begin to run out of oil, rising prices for oil will help conserve the remaining supply and encourage the development of, say, solar energy.

This seems so simple that you ask why doesn't it happen. The catch is that for the process to work, for this automatic carrot-and-stick method to be effective, some people will seem to gain and others seem to lose. In the case of oil, the oil companies may gain windfall profits, the small farmer may have to pay much more to run his tractor. So the

problem of inequity raises its ugly head. The average American has such strong feelings about fair play that it is hard for him to let an impersonal market system work out a solution. You may argue with him that it is all for his own good and that if producers are not given some incentives to produce there will be nothing for him to consume. But I suspect a good many Americans would rather line up at the gas pump than see oil companies get windfall profits.

This poses a real dilemma for policymakers, but not an irreconcilable one. The price system can do a much better job than controls in dealing with the resources problem. It should be allowed to work. Together with a free rein for development of new technology it can help to stretch out existing resources, develop new substitutes, and direct them to the most productive uses.

The equity problem requires taking a long view. At times some producers may have to be rewarded especially well when supplies are short and there is a need to expand them. Over a longer period, however, it should be easier, through tax and subsidy programs of government, to prevent gross inequities from persisting.

Obviously, this kind of solution is a trade-off. Completely controlled prices in the interests of equity can create havoc. Complete laissez-faire without regard to equity will not be accepted by the American public. Policymakers must steer a course in between.

I have hopes that this can be done with some degree of success. If it can, the Mother Hubbard scenario need not be in our future for a long time to come. I see no need for it to foreclose many more golden years.

## GONE FISHIN'

The other threat to the golden age is the Gone Fishin' scenario. This would have the American people become so unproductive as to slow growth at best to a sluggish pace. The horrible example held before us is England where, it is said, factories are inefficient,

managers incompetent, and workers preoccupied with afternoon tea. The welfare state attempts to give everything to everybody from cradle to grave, but no one is interested in producing enough to make it all possible.

How realistic is this for America's future? I can see two aspects of this scenario, one of which doesn't seem a threat, the other of which does. The first is the work ethic. This is a distinctively American phenomenon that is credited with many of the advances in well-being that we enjoy. We want more things and are willing to work for them; we work hard and so produce more. Now I have tried to get a fix on the reality of the work ethic. Many respected observers claim it is real and cite studies and statistics to support their view. Others point to the dehumanizing aspects of the assembly line, a decline in pride of workmanship, and cheaters on unemployment and welfare roles. Both are probably right. On balance, I'm inclined to place a good deal of faith in the work ethic. We have more important things to worry about.

One of them is a lag in investment in productive plant and equipment. In a recent speech Arthur Burns has explored the problem at length, and I commend it to you.<sup>2</sup> The conclusion is that business is not investing sufficiently in new productive capacity to ensure rapid growth in output in the future. Many reasons can be brought to bear. Business has experienced a number of major shocks in recent years, uncertainties abound, and profits have been relatively low. My own assessment is that matters have not proceeded so far that corporate leaders would

rather go fishin', but this is a danger to be guarded against.

Again, in both aspects, equity plays an important part. The work ethic will disappear if fair rewards for work are not forthcoming, and investment can languish if business profits are unfairly low.

In short, I see more threats in the *Gone Fishin'* scenario than in the *Mother Hubbard* scenario. But they are still only threats and it is by no means too late to deal with them.

## CONCLUSIONS

So I am optimistic. Intelligent action by those in responsible positions in the private and public sectors *can* continue whatever goldenness we may have enjoyed in the last 30 years. That is to say, economic growth can continue to be rapid, technological advances can proceed apace, resulting enhancement of material well-being can flow to society.

This is *not* to say that life will be just the same. We will be increasingly conscious of the *Mother Hubbard* problem. We can no longer be so profligate in our use of resources or abuse of the environment. And I suspect we will be sufficiently impressed with the *Gone Fishin'* scenario as to go fishin' more often. Studies suggest that there is not always a clear relationship between happiness and affluence. I believe the American people will continue to seek more material things, but increasingly they will be seeking happiness and whatever, in addition to things, they need to produce it—leisure, contemplation, and escape from the rat race. Over a century ago a great economist, John Stuart Mill, envisioned a time when we can turn our minds to "improving the Art of Living" rather than being "engrossed by the art of getting on." In this sense we can look forward to a truly golden age.

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<sup>2</sup>Arthur F. Burns, "The Need for Better Profits." An address delivered at Gonzaga University, Spokane, Washington, October 26, 1977.

# Potential Competition and the Banks

*By Timothy Hannan\**

Competition is the first line of defense against high prices and poor service. The more competitive a market is, the more likely it is to offer relatively high grades of goods and services at relatively low prices. This maxim applies to a regulated industry like banking just as it does to any other form of commercial endeavor. Faced with a host of competitors, a bank has to convince customers that the services it provides are somehow superior to those offered by other banks. With fewer competitors, this pressure is reduced.

Regulation of mergers is one of the chief tools that policymakers use to encourage competition. The name of the game here is to keep major banks in the same market from merging with one another if the merger

would reduce competition in that market. As many frustrated bankers with the urge to merge have discovered the hard way, this policy tool has become a serious bar to bank acquisitions.

But what about banks that don't compete in the same market? Can the distant presence of one such bank affect the rates that another bank charges or the services that it offers? Do banks have an impact on one another that's not a matter of actual competition in the same market? Many economists think they do have such an impact. Their reasoning is that the threat of competition from institutions in other markets, and the fact that these institutions someday may compete directly, can make bankers alter their behavior. If these economists are right, then clearly there's a place for regulatory initiatives that go beyond the encouragement of intra-market competition.

At present, this subject is being discussed under the rubric 'potential competition'. But there appears to be some confusion about

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\*The author, who holds a Ph.D. from the University of Wisconsin, specializes in banking and urban economics. He joined the Philadelphia Fed's Department of Research in 1974.

just what the expression 'potential competition' describes. If so, the first step in clearing it up will be to show how competition of the ordinary sort works in a single market. Then it should be easier to see what happens when an outside firm threatens to enter a market and what happens when it actually moves in.

### COMPETITION, PRICES, AND PROFITS

Economists have been looking at the relation of competition to prices and profits for hundreds of years. Dissected, poked, and prodded from almost every conceivable angle, this relation is perhaps the most thoroughly studied item in the whole of economics. Theories have changed over time. But from the crudest eighteenth-century formulations on up to the most recent and sophisticated theorizings, the conclusion almost always has been the same: more competitors and competition in a given market show up in lower prices and (when applicable) better service. This conclusion has been confirmed by statistical studies of many industries, from the most obscure to the most visible. Not to be outdone by their counterparts in other industries, banking economists usually have come up with the same finding: competition makes a difference. For markets in general, this conclusion is about as well accepted as anything ever gets to be in the argumentative world of the economist. It's not surprising, therefore, that a great deal of antitrust legislation, much of it bearing on the banking industry, has been founded on this conclusion.

But when a banker thinks of competition, he may have tomorrow's in mind as well as today's. There's always a chance that a new bank will enter a given market, if permitted, especially if that market is unusually profitable. If the new bank moves in independently instead of merging with a local bank, the local bank may lose business or have to make a stronger effort to retain its customers by giving them more or better services or lower prices—which could reduce profits.

And bankers, like other businessmen, don't like to see their profitability drop.

Under these circumstances, the local banker has a choice: either make the market less attractive to outsiders now by charging less for services, or continue profitability at a higher level now and run the risk of having more competitors and lower profits in future.

**Limit Pricing: Response to a Threat.** The exercise of restraint in pricing, based on the fear that higher prices—and hence profits—would invite competitive firms into a market, goes under the name 'limit pricing'. In a limit-pricing situation, the threat of entry by outsiders influences the present conduct of firms in a market *even though no market entry occurs*. The outcome may be seen in lower rates for loans, higher interest on deposits, and lower service charges—all good things, from the customer's point of view.

The key assumptions here are two: that bankers who might invade a market (potential entrants) tend to base their decisions on the prices and profits of firms already operating in that market; and that local firms tend to respond to the potential entry threat with pricing policies designed to get the most out of profits over the long haul, despite the effect on short-term earnings. Are these assumptions borne out? Economists disagree. But it's clear that, if limit pricing does occur, it may be an important ally in the effort to keep prices at competitive levels.

Even better, it's an ally that comes to the rescue when it's needed most. If a banking market is highly competitive, prices already will be relatively low and the consumer will be relatively well served. There will be little reason to be concerned with an entry threat, since outside banks won't have the promise of unusually high prices or profits to lure them in. But where a dominant bank in a noncompetitive market is considering a price rise or a service reduction, the entry threat may be important, since it's likely that new firms will be attracted by the higher price structure. In this latter case, where market

competition is weak, limit pricing should be working to hold down prices and profits.

Thus the threat of entry posed by an outsider can be serious business. But this is not the only way that the outsider can affect prices and services in a market. The potential competitor also can decide to move in and start actually competing.

**After the Threat: Post-Entry Impact.** The bank that enters a new market by opening a branch on site may have some effect on prices and services. It's well known that more competitors in a market usually pre-empt lower prices or better services. So an outsider that's likely to add to the list of competitors by entering a new market can be useful to have around.

The notion that an outsider may improve competition in a market by actually entering it, rather than by simply threatening to enter it, is what economists have in mind when they speak of probable future competition.<sup>1</sup> While the influence of limit pricing is reflected in market conduct now, probable future competition is concerned with the prospect of an improved market structure—a better number and mix of market competitors—later on. Since the entry of new competitors is more important when competition is relatively weak, actual market entry too is likely to be of greater significance in markets that are less competitive.

Thus limit pricing and actual market entry in the future both may be sources of increased market efficiency. But knowing that efficiency may be promoted in these ways isn't enough for economists, regulators, and policymakers. They want to know when in fact these phenomena occur and how much of a difference they make.

<sup>1</sup>This term was introduced by Stephen A. Rhoades. For a further discussion, see his "Clarification of the Potential Competition Doctrine in Bank Merger Analysis," *Journal of Bank Research* 6 (1975), pp. 35-42.

## EVIDENCE FOR POTENTIAL COMPETITION

It's not easy for the observer to identify a case of limit pricing. As a result, evidence that it occurs at all has been woefully lacking. One way to pinpoint it in banking would be to measure the threat of entry faced by local banks and then to see whether banks that face greater entry threats tend to charge lower prices for their services. State branch banking laws often narrow the field of new entrants by indicating which banks are permitted to enter a given market and which are excluded. Using the state branching laws as a starting point, the Philadelphia Fed currently is conducting research to determine whether limit pricing is a factor in the way some banks operate. Identifying occurrences of limit pricing remains a pretty tough task, though, and evidence from many different studies employing different methods may be necessary before the question can be truly resolved.

The evidence for a new entrant's post-entry impact is much better than the evidence for limit pricing. It's not hard to observe that some banks enter new markets and that more banks in a market usually bring more competition and a better break for the consumer. In Pennsylvania, for example, more competition in local banking markets has been found to result in higher rates paid for savings deposits.<sup>2</sup> But for

<sup>2</sup>See, for example, C. Glassman, "Banking Markets in Pennsylvania," in *Changing Pennsylvania's Branching Laws: An Economic Analysis*, Technical Papers, Federal Reserve Bank of Philadelphia, 1973, pp. 19-41. Other studies that confirm the relation of competition to the prices banks charge include D. Jacobs, "Business Loan Costs and Bank Market Structure," National Bureau of Economic Research, 1971, and F. Edwards, "Concentration and Competition in Commercial Banking: A Statistical Study," Research Report No. 26, Federal Reserve Bank of Boston, 1964. For a study of market entry by banks see S. A. Rhoades and A. J. Yeats, "An Analysis of Entry and Expansion Practices in Bank Acquisition and Merger Cases," *Western Economic Journal* 10 (1972), pp. 337-345.

policy purposes it would help to know also just how likely it is that any given outside bank will enter a market and how consequential the effect is likely to be. What will be the result if a bank new to the market starts bidding for consumer funds and business? And what will be the result if an outside bank acquires or merges with a bank that's already in the market? These are questions of magnitude that policymakers try to consider when they recommend changes in the branch banking statutes and chartering practices or review applications for merger.

### **NEW ENTRY: TO MERGE OR NOT TO MERGE**

If potential competition has procompetitive effects, then it ought to have a bearing on which mergers are allowed to take place. A neighboring bank weighing the pros and cons of invading a new market by setting up new branches may cause more competitive behavior now, because it is threatening to enter the market, and a more competitive market structure later on, if it makes good that threat. But these advantages may be lost if our potential entrant is allowed to merge with a bank already in the market. Such a merger could reduce the new-entry threat faced by banks pondering price increases in that market. And it could eliminate the opportunity to get an extra bank into the market at some future time, and thus the chance to generate more market competition. Either way, potential competition suggests an argument against certain mergers, and this fact has not been lost on the people who are charged with maintaining competition in banking (see **THE REGULATOR'S DECISION**).

It would be a mistake, of course, to presume that mergers of banks in different markets always are undesirable. In some cases, the infusion of capital and managerial efficiency can turn a weak market competitor into an aggressive one, offering a greater array of services, lower prices, and increased convenience to customers. A sizable benefit may accrue also in the case of a failing

bank, where an opportune merger with an outsider may save the local banking market from becoming even more concentrated. But against these potential benefits must be weighed the costs of losing potential competition. By eliminating the entry threat posed by the outsider, a merger of banks in different markets may reduce pressures that currently keep prices down. And to this must be added yet another cost if the outsider lost through merger in fact would have entered the market on its own and added to the market's future list of competitors. These are separate and distinct costs which, if known with accuracy, could be compared with whatever benefits might result from mergers to arrive at a correct decision in every case. The trick then is to consider the benefits and costs in each case and to weigh them against one another. And that is almost a definition of one of the aims of bank regulatory policy.

### **REGULATING BANKS IN A POTENTIAL-COMPETITION ENVIRONMENT**

In their attempt to oversee the banking industry where potential competition may be important, regulators face two severe difficulties—lack of information and regulatory inconsistency.

The information gap is unavoidable. While it may be useful to know that the competitive impact of a given merger can be decomposed into several different forces, some beneficial and some not, the inability to assess the magnitudes of these forces makes regulatory decisions difficult. Measurement of entry threats is especially difficult, and very little evidence has been available to guide decisionmaking here. Predicting the results of bank mergers in different markets is such a slippery undertaking because, even where potential competition is well understood, very little is known about the impact that potential competition can have in terms of dollars and cents. By how much, for example, will prices and services in a market be affected if the threat of entry into that market is reduced because of a merger? Until this

## THE REGULATOR'S DECISION

Banks compete with one another for customers in certain geographic areas—local banking markets. In order to reach a decision about a proposed merger of two banks, regulators first must determine where the relevant banking markets are. This determination often is made by analyzing data on population, commuting patterns, bank locations, and other conditions, that may be useful in marking off the areas where banks compete. To see the situation that regulators must come to grips with once the boundaries of these markets have been determined, suppose that Market A contains Bank 1 and Bank 2, neighboring Market B contains Bank 3, and Bank 3 is applying for permission to merge with Bank 2.



If Bank 3 is allowed to merge with Bank 2, it will be lost as a potential entrant into Market A. If banks in Market A keep their prices down out of fear that Bank 3 might enter with a new branch, then the loss of Bank 3 as a potential entrant may mean higher prices and fewer happy customers in Market A. This is how limit pricing can affect the desirability of allowing a merger.

Also, suppose that there is a high probability that Bank 3 will enter Market A with a new branch if it is not allowed to merge with Bank 2. If the merger is not approved, customers in Market A may benefit at some future date from having three different banks compete in their market instead of the present two. This would be an application of the concept of probable future competition, and it too could be relevant to the regulator's decision.

Of course, it's often difficult to determine how important these considerations are in any given case, and against the cost that may result from losing Bank 3 as a potential entrant into Market A must be weighed the benefits that might result from the merger itself.

question is resolved, some incorrect decisions may be the unhappy result.

More avoidable, perhaps, is the variety in the treatment accorded potential competition cases by different government agencies. The often tortuous route from merger application to final approval or denial can involve the state banking authorities, the Federal Reserve System, the Federal Deposit Insurance Corporation, the Comptroller of the Currency, the Justice Department, and dif-

ferent levels of the courts (see THE SUPREME COURT. . .). And concern has been voiced that not all of these branches of government march to the same economic drummer. In the words of one critic: "Differences in the relationship of economic theory to Federal regulatory policy, on the one hand, and to guidelines laid down by the courts, on the other, are evidenced by the eight successive failures of the Justice Department to win a banking organization mer-

ger case in the district court when invoking the potential competition doctrine."<sup>3</sup>

### DOING THE BEST WITH WHAT'S AVAILABLE

The current state of knowledge may not be

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<sup>3</sup>Gary G. Gilbert, "The Potential Competition Doctrine in Commercial Banking: Theory and Policy," in *Conference on Bank Structure and Competition*, Federal Reserve Bank of Chicago, 1974, pp. 140-156.

sufficient to guarantee a correct decision in every case, but it does indicate some useful guidelines to follow in making better decisions about potential competition. While more knowledge about the dollars-and-cents impact of potential competition certainly would help in the comparison of benefits to costs, it still is useful to make some appraisal of where potential competition is likely to be important and hence where regulatory action is more likely to produce the greater benefit. It's known, for example, that

## THE SUPREME COURT AND POTENTIAL COMPETITION IN BANKING

Recent Supreme Court decisions involving potential competition in bank merger cases have addressed in detail some of the important underlying issues. The opinion handed down in the recent *Marine Bancorporation* case, for example, shows how the Court tends to view these issues.\*

This case stems from the attempted acquisition of the Washington Trust Bank (WTB) of Spokane by the National Bank of Commerce (NBC) of Seattle, a subsidiary of Marine Bancorporation, Inc. As is evidenced by its opinion in this case, the Court sharply distinguishes probable future competition from limit pricing and recognizes the conditions under which each may need to be considered.

In regard to probable future competition, the Court noted that before it was possible to determine that the antitrust laws had been violated, it had to be shown "(1) that in fact NBC has available feasible means of entering the Spokane market other than by acquiring WTB; and (2) that those means offer a substantial likelihood of ultimately producing deconcentration of that market [reducing the share of deposits held by the largest banks] or other significant procompetitive effects."† Because Washington state branching laws make it difficult for a bank to enter a new market other than by merger, the Court held that the conditions for probable future competition were not satisfied in this case. The question of Court action if these conditions are satisfied has yet to be resolved.

The applicability of the limit-pricing concept was examined and also rejected in this case. Since the regulatory barriers keep NBC from posing a serious threat of entry except by merger, the Court reasoned, it is unlikely that this bank would exert any meaningful procompetitive influence over Spokane banks by standing in the wings.

From recent decisions, then, it appears likely that the Court may consider potential competition where state laws don't restrict bank expansion. Whether it will consider potential competition in other circumstances is a question yet to be answered.

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\* 418 U. S. 602 (1974).

† 418 U. S. 623.

the less competitive a market is, the greater is likely to be the benefit that results from potential competition. The threat of entry now or the prospect of entry later by an outside bank means little in a competitive market but may have a sizable influence in a non-competitive one. It seems likely also that the more ready, willing, and able a bank is to branch into a new market, the more credible is the entry threat it poses and the more likely is its actual entry in the future. Thus a large, well-managed bank with a history of branching activity is likely to have a bigger impact as a potential entrant than a small, un-aggressive one. Finally, the fewer the banks that are willing and able to enter a market, the more important it is when any one of these banks is lost through merger, if potential competition is a factor.

Together, these considerations indicate a policy that regulatory agencies often follow: take action against a proposed acquisition when the market in question is highly non-competitive and when the outsider is one of only a few banks that might enter with a new branch.

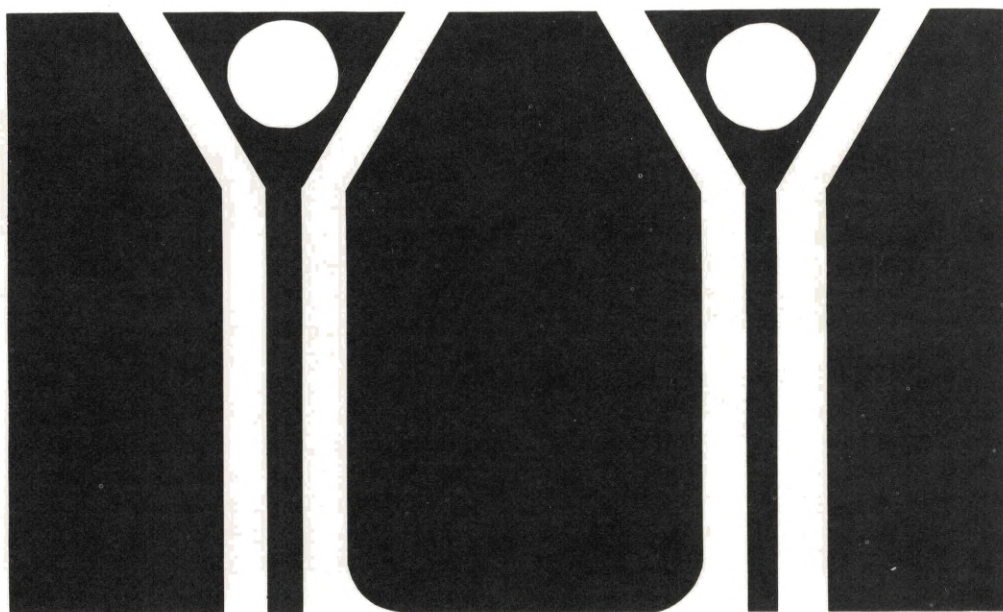
For now, a policy based on knowledge of when potential competition is likely to be important, bolstered by a fair amount of educated guessing, probably is the best that can be hoped for. Better information about the significance of potential competition in banking would make future decisionmaking

a little easier. But even in the present state of our knowledge, drawing the line somewhere in bank merger policy is likely to be better than not drawing it at all.

An altered bank merger policy is not the only vehicle by which more information about potential competition could change things for the customer. Potential competition is relevant also to decisions about branch banking restrictions and chartering procedures. The fact that legal restrictions on branch banking may reduce the threat of entry as well as actual entry into local banking markets surely must be considered in assessing the desirability of such restrictions. Similarly, information on the extent to which chartering requirements for new banks reduce the list of potential competitors someday may have a significant influence on decisions about such requirements. Then too there are the recent moves to make other financial institutions more closely competitive with commercial banks, such as the authorization of negotiable order of withdrawal (NOW) accounts for mutual savings banks. Changes in the number and mix of competitors may have an impact not only on regular competition within banking markets but also on potential competition. As we gain more information on potential competition, we may yet find it to be a valuable ally in keeping banking markets competitive and banking customers happy.

**From the  
Philadelphia FED...**

**ECONOMIC MAN  
vs. SOCIAL MAN**



**AND OTHER TALKS**

**By David P. Eastburn**

Copies of this new publication are available without charge from the Department of Public Services, Federal Reserve Bank of Philadelphia, 100 North Sixth Street, Philadelphia, Pennsylvania 19106.

# The Fed in Print

## Business Review Topics, First Half 1977

*Selected by Doris Zimmermann*

Articles appearing in the Federal Reserve *Bulletin* and in the periodic reviews of the Federal Reserve banks during the first half of 1977 are referenced in this compilation. A cumulation of references for the period 1974 to date is available upon request from the Department of Public Services, Federal Reserve Bank of Philadelphia, 100 North Sixth Street, Philadelphia, Pennsylvania 19106.

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**BUSINESS  
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Federal Reserve Bank of Philadelphia

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