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ECONOMIC REVIEW

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November/December 1977

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PATTERNS EMERGE

INTERNATIONAL BANKING IN THE SIXTH DISTRICT[1]

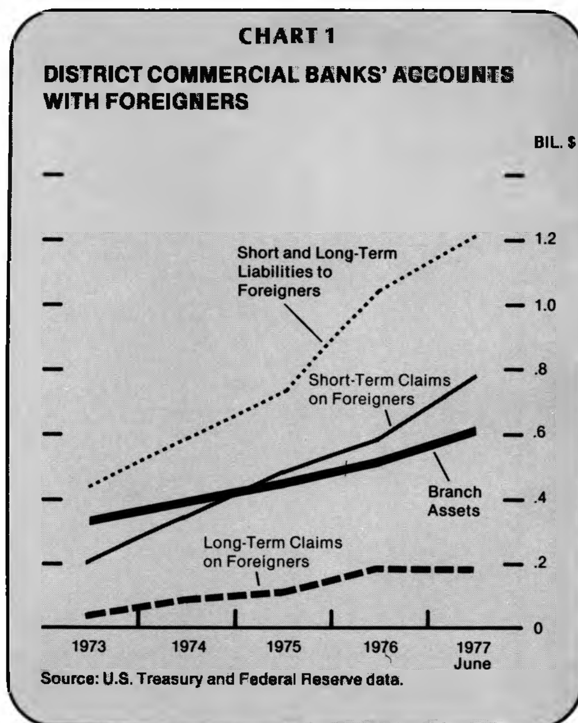
by Donald Baer and David Garlow

Although international banking activity has expanded rapidly nationwide in recent years, Sixth District international activity has grown even faster. Today, 39 commercial banks in the Sixth District boast active international departments. The scope and horizons of commercial banks' international departments run the gamut from a desk or two on the main floor or in a remote corner of the bank to a multioffice operation with domestic subsidiaries, foreign branches, and representation abroad.

THE RECORD: SIXTH DISTRICT INTERNATIONAL BANKING GROWTH

The "active" international departments in the Sixth District are concentrated in the Southeast's ports and major inland cities (see Table 1). Although certain port cities have had small international operations for decades, most District international departments have been established since 1960. It was not until the 1970s, however, that District international banking activity really mushroomed.

Growth in international banking at domestic offices in District banks has outstripped the national average. From December 1973 to June 1977, foreign deposits in these offices increased 171 percent, from $447 million to over $1.2 billion. District loans to foreigners increased even more rapidly.[2] But activity at foreign branches of District banks has grown less than it has nationwide (see Table 2). The overall trend, however, is clear: International banking is becoming an increasingly expected and accepted activity for larger banks located in District trade centers.



Source: U.S. Treasury and Federal Reserve data.

THE PATTERN OF DISTRICT INTERNATIONAL BANKING

Has there been a pattern to the growth of regional international departments? After a series of interviews conducted between October 1976 and October 1977 with over 30 District international departments and a thorough evaluation of the data available, we have concluded that in spite of great diversity, there have been 4 distinct phases in the development of regional international banking.

The pattern to be described here is not universal. Certain banks, upon reaching a given phase, feel comfortable with the

[1] This article complements our analysis of Edge Act corporations in Miami which appeared in the Federal Reserve Bank of Atlanta's September/October 1977 **Economic Review.**

[2] All banking data in this article exclude all Edge Act activities of banks headquartered outside the District.

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TABLE 1
DISTRICT COMMERCIAL BANKS WITH ACTIVE INTERNATIONAL DEPARTMENTS

ALABAMA (5)
- Birmingham:
  - Birmingham Trust National Bank
  - First National Bank of Birmingham
- Mobile:
  - American National Bank and Trust Company of Mobile
  - First National Bank of Mobile
  - Merchants National Bank

FLORIDA (19)
- Jacksonville:
  - Atlantic Bank
  - Barnett Bank of Jacksonville
  - Flagship State Bank of Jacksonville
  - Florida First National Bank of Jacksonville
- Miami:
  - Bank of Miami
  - Barnett Bank of Miami
  - Central Bank and Trust Company
  - City National Bank of Miami
  - Coconut Grove Bank
  - Flagship Banks, Inc.
  - Miami National Bank
  - Pan American Bank of Miami
  - Peoples Downtown National Bank
  - Republic National Bank of Miami
  - Royal Trust Bank of Miami
  - Southeast First National Bank of Miami
- Tampa:
  - Exchange National Bank of Tampa
  - First National Bank of Tampa
  - Flagship Bank of Tampa

GEORGIA (5)
- Atlanta:
  - Citizens and Southern National Bank
  - First National Bank of Atlanta
  - Fulton National Bank
  - National Bank of Georgia
  - Trust Company Bank

LOUISIANA (5)
- New Orleans:
  - Bank of New Orleans
  - First National Bank of Commerce
  - Hibernia National Bank in New Orleans
  - National American Bank of New Orleans
  - Whitney National Bank of New Orleans

MISSISSIPPI (1)
- Jackson:
  - Deposit Guaranty National Bank

TENNESSEE (4)
- Chattanooga:
  - American National Bank and Trust Company
- Nashville:
  - Commerce Union Bank
  - First American National Bank
  - Third National Bank in Nashville

type of international department they have and plan no further alterations of activities. The phases elaborated here pertain to the development of District bank international credit. Although it cannot be denied that foreign deposits have been a significant stimulus to the development of international banking in the foreign deposit centers of Miami and New Orleans, it is the credit activities which most necessitate specialized international departments. Furthermore, it is the types of credit activities undertaken by District international departments which most clearly distinguish the phases of international department development.

Phase I: Trade Financing for Local Exporters and Importers. The expanded importance of U.S. merchandise imports and exports explains in large part the initial phase of this region's international banking. In 1976, U. S. exports reached $115 billion, nearly three times the 1970 level. Exports represented 6.7 percent of 1976 GNP, compared to 4.3 percent in 1970 and 3.9 percent in 1965. Import growth has been even more rapid. As foreign trade has expanded, regional banks in major District cities have been increasingly called upon to finance and facilitate their customers' trade. Somewhere along the line, banks in our region, as elsewhere, have been faced with a major decision: Should such trade financing be directed to their money center correspondent banks or should the regional bank develop its own international expertise? Thirty-nine District regional banks have decided that it would be opportune for them to finance such trade directly.

Trade financing and payments involve foreign collections, drafts, letters of credit, acceptances, and direct loans. Banks usually find that establishing correspondent banking relationships abroad is necessary to successfully undertake these trade credits and payments, as a foreign bank is either directly or indirectly required to help process documents.

In this first phase, international departments put forth a great effort to inform their banks' customers of the trade financing and other services that are offered (travelers checks, foreign exchange,

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TABLE 2
GROWTH IN DOLLAR VOLUME OF INTERNATIONAL ACCOUNTS WITH FOREIGNERS
SIXTH FEDERAL RESERVE DISTRICT AND U. S. COMMERCIAL BANKS
(percentage growth)

		December				
		1973-1974	1974-1975	1975-1976	Dec. 1976-June 1977	Dec. 1973-June 1977
Parent Bank						
Short-and Long-Term Liabilities to Foreigners	District	32.6	23.8	43.7	15.0	171.2
	U. S.	36.2	0.1	15.8	4.5	65.0
Short-Term Claims on Foreigners	District	72.4	40.4	22.1	33.6	294.6
	U. S.	88.5	28.6	37.6	2.1	240.5
Long-Term Claims on Foreigners	District	81.6	40.1	69.3	1.9	338.7
	U. S.	19.7	32.8	22.3	4.7	103.6
Branch						
Total Assets	District	17.2	15.1	16.4	16.3	82.6
	U. S.	24.6	16.2	24.3		

Source: U. S. Department of the Treasury, **Treasury Bulletin**, and other Treasury and Federal Reserve data.

etc.). Such an effort is required to win a share of the trade financing that has formerly gone to regional competitors or money center banks. International departments sell their trade financing services over a wider area than their domestic credit services, since there are few "active" international bank departments outside of major cities (see Table 1).

Trade financing activity has been and still is the core of a typical regional bank's international department. About a quarter of District banks with international departments offer only this basic international service at this time.

Phase II: Loans to Foreign Banks and Loan Participations. As regional international departments become more familiar with the foreign countries with which their customers trade and begin to work regularly with the international departments of U. S. correspondent banks and with foreign commercial correspondent and central banks, further profitable international financial opportunities typically become evident. These new fields are usually participations in foreign loans set up by money center banks and extensions of lines of credit to foreign commercial banks.

Participation purchases of loans organized by money center banks provide international departments with loan opportunities without extensive foreign travel. Still, the proposals require evaluation; the money center bank arranges the loan participations but does not guarantee them. Participation purchases generate earnings for the regional bank as well as offer a chance to learn to evaluate international loans. Participations may build stronger correspondent relationships with the money center banks and "get the bank's name around" but usually are of limited value in terms of self-generated future loans abroad.

Extension of direct lines of credit to foreign commercial banks provides international departments with additional opportunities to build loan volume and evaluate foreign economies and financial institutions. These loans normally involve less risk and more limited foreign travel than direct loans to nonfinancial foreign firms.

Banks view the extension of international department activity into participations and loans to foreign banks as a decision for senior management (and the international department) as major as the initial decision to set up an international department. The final decision hinges on their assessment of local international financial needs, competition, liquidity, risks, current and potential profitability, and availability of trained manpower. About 40 percent of the District international departments interviewed may be described by this second phase.

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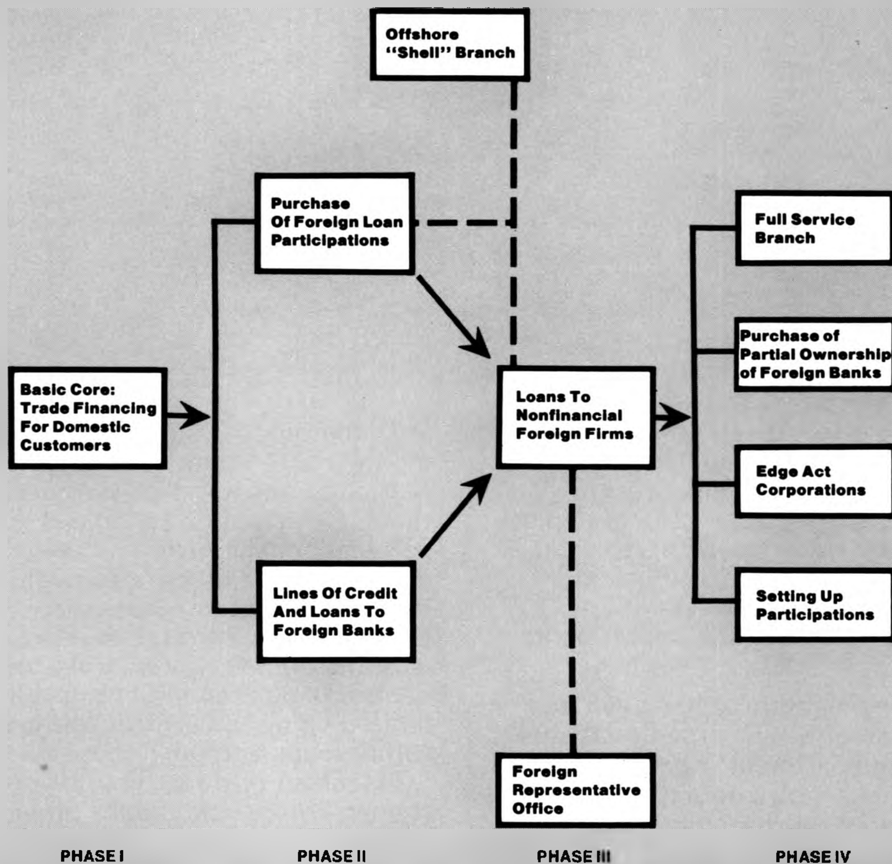

Phase III: Direct Loans to Foreign Nonfinancial Firms. As international activity grows, regional banks begin to develop contacts with nonfinancial firms abroad. One channel is through direct participations with foreign correspondent banks who have local clients with financial requirements they cannot meet completely. Closer contacts with the foreign suppliers of U. S. imports and foreign buyers of U. S. exports with whom the regional bank may have dealt indirectly in trade financing may also lead to direct loans to foreign business firms. Typically, the regional bank works with well-known, established firms. Some District banks concentrating on the development of such foreign business loans open representative offices in a strategic country abroad. Most, however, have decided that recurrent foreign travel from the home office suffices.

International departments currently in Phase III are those where trade financing, bank participation purchases, and lines of credit to foreign banks continue, but the new activity, direct loans to foreign business firms, accounts for an increasing share of international departments' loan portfolios. About a third of internationally active District banks could be described as in this phase. Four District international departments have more or less jumped from Phase I to Phase III without engaging

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extensively in participation purchases and loans to foreign banks. Such jumps have been possible through contacts built in offering personal banking services to foreigners from head offices, particularly in foreign deposit-taking centers such as Miami and New Orleans, or through extensive foreign travel.

Phase IV: Subsidiary Establishment and Loan Syndication. Once an international department is offering credits to diversified types of institutions, many of the distinctions between such a regional international department and a money center international department may be eroded. The domestic marketplace, however, may still be perceived as the Southeast for the District regional bank, while the money center bank may perceive the U. S. as its domestic marketplace. The regional bank may consider opening subsidiary international offices in the U. S. as Edge Act corporations or foreign full-service branches or acquiring shares of foreign banks. Eventually, as the regional bank gains international financing stature, it may regularly syndicate foreign loans. This phase of international development requires legal expertise as well as a continuing commitment to participation purchases from other syndicating banks. No District banks are fully into this final phase, although a few are increasingly performing certain functions that characterize it.

THE DIVERSITY OF SOUTHEASTERN INTERNATIONAL BANKING

The phases described above provide a system of classification for the extraordinarily diverse group of international banking departments in the Southeast. With this four-phase pattern in mind, we now turn to a more detailed discussion of the policies and portfolios of banks' international departments, as indicated by their interview responses.

Type of Borrower Preferred. Southeastern international bankers most frequently indicated that they prefer to lend to foreign banks as opposed to nonfinancial borrowers. Since a correspondent relationship with a foreign bank is often one of the earliest additions to a bank's international services, it seems natural that many banks use these contacts to place funds abroad. Loans to finance trade transactions of U. S. corporate customers and loans with some form of government guarantee were also popular (see Table 3). These preferences indicate that risk avoidance may play at least as strong a role in banks' foreign lending decisions as maximization of the "spread" (defined as the interest rate received on a loan minus the cost of funds to the bank). U. S. corporations can be tried in U. S. courts in the event of noncompliance with loan agreements, and "guaranteed" loans provide an increased measure of security.

TABLE 3
TYPE OF LOANS PREFERRED BY INTERNATIONAL DEPARTMENTS OF SIXTH DISTRICT BANKS

Type of Loan Preferred	No. of Banks Preferring This Type*
To Private Foreign Banks	12
To Private Nonbank Foreigners	5
"Guaranteed"	6
Those to Finance U. S. Customers' Trade	7
Those Available for Export-Import Bank Support	3
No Special Preference	3
To Foreign Governments	1

Source: Interviews
*Since many banks expressed preferences for more than one type of loan, the column total is greater than the number of banks interviewed. The types of loans are not mutually exclusive; for example, a loan available for Eximbank support may carry an Eximbank guarantee.

Long-Term Lending. The attitude of southeastern international departments toward long-term lending is also rather cautious. Almost 60 percent of the banks visited stated that they had some loans with maturities of a year or longer. Southeastern bankers reduce their interest rate exposure by making longer-term loans at rates that are adjusted frequently. However, their risk of incurring nonperforming loans is greater when they offer funds with long maturities, thereby reducing their freedom to reallocate funds if individual borrowers experience difficulties. A bank that places a small proportion of its portfolio in long-term loans abroad is not throwing caution to the winds, of course. Districtwide, a little less than a fifth of the foreign portfolios of parent banks (excluding branches and subsidiaries) are long term and many bankers interviewed were avoiding new long-term commitments.

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TABLE 4
LATIN AMERICAN CONCENTRATION OF INTERNATIONAL BANKING ACTIVITIES, SIXTH FEDERAL RESERVE DISTRICT MEMBER BANKS COMPARED TO ALL U. S. COMMERCIAL BANKS
(Figures are Latin American percentages of corresponding dollar totals for all foreigners as of December 31, 1976.)

	All Sixth District Reporters	All U. S. Reporters
Liabilities of U. S. Parent Banks to Foreigners	89	17
Short-Term Claims of U. S. Parent Banks on Foreigners	74	49
Long-Term Claims of U. S. Parent Banks on Foreigners	82	41
Claims on Foreigners Booked at Foreign Branches of U. S. Parent Banks	64	23

Source: U. S. Department of the Treasury, **Treasury Bulletin** and other Treasury and Federal Reserve data.

This cautious attitude toward long-term commitments is one factor that accounts for the generally low participation of District international departments in syndicated loan packages, which usually have maturities of five to seven years.[3] Less than half of all departments visited had participated in such packages. Those that had participated tried to subject these participations to evaluations as stringent as those they would make of domestic loan applications. In a few cases, international departments sought comments from banks not associated with a proposed syndicated package before deciding on their own participation.

Geographical Specialization. Nineteen District international departments have chosen to concentrate on a particular geographic area. In the majority of these banks, the area includes part or all of the Caribbean Basin.[4] As of December 1976, for example, about 82 percent of District parent banks' long-term foreign claims were on foreigners located in Latin America (a designation that includes the Caribbean Islands), compared to only 41 percent of reporting banks nationwide. Similar comparisons of parent banks' short-term claims, their liabilities to foreigners, and the assets of their foreign branches also reveal the Latin American concentration of District banks' international portfolios relative to those of all U. S. commercial banks (see Table 4).[5]

Bankers interviewed explained this specialization as deriving from their knowledge of the area, its closeness to their U. S. location, and its importance to the trade transactions of their customers. Few banks cited other factors which one would expect to influence this kind of decision such as less competition or higher growth prospects in a given country or countries. It may be that profit and growth prospects originally did influence the international departments' area choices, but some of the bank officials we interviewed were recent arrivals and were unaware of the background of decisions made early in the departments' history. But the reasons given for area specialization and the fact that these banks are concentrating their efforts in only a few economies may also reflect the heavy expense of establishing expertise in foreign financial matters. Future changes in banks' areas of specialization may provide a clue to the relative weights of the cost of investment in expertise and the perceived profit opportunities in decisions of where to lend. International departments that make only small and infrequent changes in the foreign markets in which they choose to lend probably prefer to build a fund of knowledge about these economies rather than react to short-run changes in the fortunes of different areas.

Fourteen of the international departments which lend to borrowers abroad periodically establish specific lending limits for individual countries, although these limits are very flexible at five banks. Most banks look at current political and economic indicators when

[3] Low participation in syndicated Eurodollar loans is, in turn, partially responsible for the low growth rates in foreign branch assets at District banks relative to the national average (see Table 2). District banks do not face the high state and local taxes on income that have encouraged some New York banks to book an increasing share of their international loans at foreign branches. See **New York Times,** March 3, 1977.

[4] The Caribbean Basin is defined to include Mexico, Colombia, Venezuela, all of Central America, the Caribbean Island economies, Guyana, Surinam, and French Guiana.

[5] One reason for this District concentration is that money which parent banks lend to their foreign branches is counted as a claim on foreigners. Since most of this money is relent by the branch–some of it to non-Latin American borrowers–and since most District foreign branches are located at Latin American offshore banking centers, the percentages given in Table 4 slightly overstate the Latin American concentration in District claims.

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establishing country limits. Other considerations, such as U. S. and state legal limits on loans to one customer, customers' needs, the purposes of loans, country ratings established by the Export-Import Bank, and past experience in the country, were mentioned occasionally as influences on decisions on when to stop making new loans to an economy.[6]

Source of Loanable Funds. Funds for the lending activities discussed above come either from resources secured in the bank's home area or, in the case of 10 District banks that have established offshore branches, from Euromarkets. Some banks use only U. S.-generated resources and some a mix of funds raised at home and abroad. Those banks that made little use of Eurodollars, as in Miami, were more liquid in most cases. Higher liquidity in Miami banks is due, in part, to the constant stream of Latin American visitors who contribute substantial resources in the form of checking and savings accounts. While some funds derive from accounts which have been maintained at the same bank for years, Miami offices also open a large number of new accounts for foreigners annually and promote this service when they travel abroad.

A few of the more sophisticated District banks obtain funds for foreign lending in both U.S. and Eurodollar markets. In determining how much to draw from each source, they consider the interest rates available and their own liquidity. When short-term funds are inexpensive in the U.S., they may fund domestically, moving to the Eurodollar markets when rates become attractive. In time of slack U.S. loan demand, they fund foreign loans with the deposits of U.S. customers to cover the cost of these deposits and to continue growing.

Profitability. No figures on the rate of return on foreign operations are publicly available for District banks. Nevertheless, almost all bankers who commented on their international department's rate of return on assets indicated that it was good to excellent, often adding that it surpassed the domestic loan department in this respect. In all but two banks, foreign loan loss experience had been generally better than on domestic loans. So far, repayments on foreign loans have been a problem for only a few U.S. banks.[7] The safety of foreign loans underlines once again the desire to minimize risks that prevail in most District international departments.

Locational Factors. The site of international banking operations greatly affects bank efficiency, according to the bankers we interviewed. The availability of frequent and reliable transportation for passengers, cargo, and mail was the factor most frequently mentioned. Miami bankers felt that the city's excellent airline and shipping connections were a definite plus to international banking. Bankers in some other cities viewed transportation as a negative factor, as poor airline connections led to costly travel delays. On the other hand, a port location does not appear to consistently favor international banking operations. Some banks located at busy ports felt this was a valuable source of international business, while other port banks (sometimes in the same city) did little trade financing.

Other factors mentioned as affecting international banking location decisions included the availability of personnel with banking experience and the presence of an international mentality. Miami and New Orleans were attractive in both respects, as bankers there felt that the Latin community provided both experienced employees and an atmosphere that drew Latin American visitors to the city. These banks received deposits from the visitors and were able to develop valuable contacts with visiting businessmen.

A few banks mentioned proximity to large U. S. exporters as an aid to generating foreign loans. Still, financing for many major multinational corporations in the Southeast is arranged in northern and Pacific Coast cities. Increasing numbers of

[6]Legal limits usually refers to the provision that U. S. national banks and state chartered banks in some states cannot have loans outstanding to one borrower that are valued at more than 10 percent of the bank's capital and surplus. This provision may affect the country limits of money center banks, especially those which lend extensively to the public sector, since a government and its associated enterprises can be considered, in some cases, to be a single borrower. But the international portfolios of District banks are, as yet, generally too small in relation to bank equity to be affected by this provision, and these answers should be taken as reflecting the general banking background of the officers we interviewed.

[7]Fred Ruckdeschel, "Risk in Foreign and Domestic Lending Activities of U. S. Banks," **Columbia Journal of World Business** X(4), winter 1975.

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TABLE 5
INTERVIEWEES' EVALUATION OF GROWTH PROSPECTS OF THEIR INTERNATIONAL DEPARTMENT, SIXTH FEDERAL RESERVE DISTRICT COMMERCIAL BANKS
(Figures are numbers of international departments.)

Prospects	Miami Banks Only	All Banks
Limited	1	15
Good to Excellent	6	11

Source: Interviews.

large corporations are moving their international department headquarters to the Southeast, however. This movement, combined with greater expertise and expanded exports from corporations long established in the area, may be a source of future growth for District international departments.

Growth Prospects. Given the generally favorable profit and repayments experience of international departments, we might expect southeastern bankers to have plans for rapid expansion of this segment of their operations. However, bankers' responses to this question differed, with only half indicating that they had plans for moderate to rapid growth. Miami bankers were substantially more bullish (see Table 5), perhaps because of their locational advantages. Bankers who felt that growth prospects for their international departments were limited usually attributed this to hesitancy on the part of upper-level management or their own doubts about their capability of handling increasingly complex operations. Recent international financial crises and newspaper articles about the quality of loans to oil-importing developing nations may help explain bank directors' caution in expanding international operations. Feelings of lack of expertise reflect, in part, the relative newness of many Southeast international departments and the competition that some face in finding and keeping experienced personnel.

Use of Foreign Travel. Banks that establish travel programs as part of their international banking activities usually develop a familiarity with the personalities and business climate abroad which boosts both the quality and size of their international portfolios. Occasional trips by senior bank management to countries where the bank has made foreign loans can build the kind of support at the top that the international department needs to strike out in new directions. More than three-fourths of District international departments have travel programs, although at 12 banks, only 1 or 2 officers make only a few trips per year. Restricting travel to a few individuals means that the growth momentum of the international department could be checked if these people leave. But the fact that so many banks have set up travel programs means that, in general, there are powerful forces for evolution rather than stagnation in District international banking.

SUMMARY

Interviews with active international departments at southeastern commercial banks suggest there is a four-phase development pattern for such operations. Since different banks are in different phases, the Southeast exhibits a diversity of size and scope in international operations. Bank preferences as to type of borrower, maturity and geographical concentration of loan portfolios, and sources of funds for international loans reveal that both risk minimization and "spread" maximization influence their credit decisions. Proximity to good transportation, a pool of skilled labor, and attractions which draw international visitors seem to favor international banking operations. About half of the bankers interviewed predicted moderate to rapid growth for their international departments in the near future. Foreign travel programs at some District banks may spur increasing sophistication in their international departments. ■

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FEDERAL FOOD DOLLARS GO SOUTH

by Patricia Faulkinberry

The recently enacted Food and Agriculture Act of 1977 includes a thorough overhaul of the Food Stamp Program. Reforms are aimed at simplifying the program, making it more equitable, improving its safeguards against abuse, and, above all, redirecting benefits toward poverty households. Once implemented, the changes will substantially increase the number of food stamp users, raise benefit outlays, and reduce administrative costs. Since the South has a larger share of poverty households than other regions of the United States, the restructuring of the program will result in a redistribution of food stamp subsidies toward the South.

PERSPECTIVE

The present Food Stamp Program, initiated in 1961, has grown from a $13-million-a-year operation, covering about 3½ percent of the population in 8 project areas, to a vast $5 billion-a-year-plus undertaking, involving about 8 percent of the population in 3,036 project areas in every state, the Virgin Islands, Puerto Rico, and Guam. Participation peaked at over 19 million recipients in early 1975, the worst of the recession, and has fallen rapidly with improving economic conditions.

Direct subsidies to participants account for almost all of Federal program outlays: In fiscal 1976, they totaled $5.5 billion, or 95 percent of total costs. Operating and administrative expenses added another $314 million for a total Federal expenditure of $5.8 billion, almost 40 percent of the U. S. Department of Agriculture's (USDA) budget. State governments contributed at least $250 million more to program administration. Participants in the "South" Census region received 42 percent of total benefits (see Box for definitions of Census regions).

The processing of food stamps involves thousands of public and private concerns which will each be affected to some extent by the new law. State agencies administer local projects in cooperation with the USDA. The Department of Health, Education, and Welfare and the Labor Department have small roles in the program. The U. S. Treasury handles financial transactions on behalf of the USDA. Coupons are currently sold to program participants by 13,250 banks, post offices, welfare offices, check-cashing firms, town clerks, fire stations, and stores. Nearly 260,000 retail food stores and another 12,500 food wholesalers, meal delivery and communal dining services, and alcoholic and drug treatment centers are authorized to redeem food stamps. Federal Reserve Banks collect and destroy used stamps that have been "cashed in" by retailers at commercial banks.

SUMMARY OF MAJOR PROGRAM CHANGES

The Food Stamp Act of 1977 contains some 20 sections, each providing for changes in one or more aspects of the current program. No attempt is made here to describe or evaluate every modification. This analysis is an examination of the changes with significant economic impact, particularly on income distributions and regional incomes. These changes may be classified as modifications of eligibility requirements, the elimination of the purchase requirement, and improvements in operations and safeguards.

Changes in Eligibility Requirements. The most important revisions to eligibility requirements establish new income standards for participants. A household may qualify for the current program if (a) 30 percent of its monthly income after

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DEFINITIONS OF CENSUS REGIONS

Northeast—Connecticut, Maine, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island, Vermont.

North Central—Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, South Dakota, Wisconsin.

West—Alaska, Arizona, California, Colorado, Hawaii, Idaho, Montana, Nevada, New Mexico, Oregon, Utah, Washington, Wyoming.

South—Alabama, Arkansas, Delaware, District of Columbia, Florida, Georgia, Louisiana, Maryland, Mississippi, North Carolina, Oklahoma, South Carolina, Tennessee, Texas, Virginia, West Virginia.

deductions is less than the cost of the USDA's Thrifty Food Plan (the basis for coupon allotments) for a household of that size or (b) it is receiving grants under the Aid to Families with Dependent Children Program, the Supplemental Security Income Program, or state and local general assistance programs. The new law lowers the net income limits to the Office of Management and Budget's nonfarm poverty income guidelines, commonly known as the "poverty line" (though the level varies by family size), and eliminates the automatic eligibility of public assistance households. The result is a considerable tightening: The current (fiscal 1978) net income ceiling of $6,800 per year for a four-person household will be reduced to $5,850 per year.

Households are presently allowed virtually unlimited itemized deductions for various expenses in calculating net income. These will be replaced by a standard deduction of $60 per month, an earned income deduction of 20 percent of gross earnings, and two itemized deductions—for shelter costs exceeding 50 percent of income after all other deductions and for the dependent care expenses of jobholders—which alone or together cannot exceed $75 per month. The establishment of deduction ceilings will allow the introduction of gross income limits for eligibility determination, clearly excluding middle income families.

Even households with net incomes below the limits must satisfy other tests to be eligible for food stamps. These, too, have been modified by the Act. "Work requirements," which eliminated 381,747 households from the program and reduced the benefits of 86,419 more from their introduction in 1971 until September 1976, will be stricter. The limit on the resources (assets) a food stamp household may own has been raised but will include the value of an automobile (in excess of $4,500) for the first time.

Elimination of the Purchase Requirement. The most sweeping program reform measure, and one which will affect both participation and administration, is the elimination of the purchase requirement (EPR). Presently, a household pays up to 30 percent (the average payment is 25.6 percent) of its net income for a coupon allotment equal in value to the cost of the Thrifty Food Plan. The amount of the subsidy, i.e., the difference between the allotment value and the payment, is referred to as the "bonus" coupon value. Under the new program, recipients will pay nothing and receive stamps worth the cost of the Thrifty Food Plan less a straight 30 percent of net income (known as the "benefit reduction" rate). Thus, benefits under the new program will be roughly equivalent to current bonus values alone.

The purchase requirement has been a significant barrier to program participation for many eligible households. Because they must retain cash for household expenses or emergencies or because their income receipts are not timely, some needy families are unable to make cash payments at the appropriate times. While the USDA estimates that about half of those eligible participate in the current program, it expects the proportion to rise to two-thirds when the EPR's full effects are felt.

The EPR will also greatly simplify program operations and cut administrative

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costs. Vendors will no longer handle cash. Consequently, access to the program may be improved, as more public agencies will be encouraged to distribute the stamps without the disincentives of safeguarding and accounting for cash. State agencies' payments to vendors may be reduced to correspond to lighter responsibilities. The volume of stamps circulating at a given level of participation will be dramatically reduced (by more than $3 billion under current conditions), relieving much of the burden on all concerns involved in any phase of food coupon processing.

Other Operations Improvements. The firming of eligibility standards and the EPR will eliminate a lot of red tape from program administration. They will also remove many incentives and opportunities for fraud. The new law specifically addresses this problem by prescribing stiffer penalties for program abuse and providing for increased Federal funding of investigation and prosecution of cases of suspected fraud.

EXPECTED ECONOMIC IMPACT

At the outset, no one can predict with certainty exactly how many people and dollars will be affected by these substantial changes in the Food Stamp Program. The USDA, with access to detailed information about current recipients and income levels, has formulated a set of projections of the impact on participation, benefits, and costs.[1] The estimates rest on assumptions of future economic conditions and a certain schedule for implementation of program changes (beginning May 1, 1978) which may or may not be met. Despite their limitations, the USDA projections may be taken as rough indicators of the likely direction and distribution of the reform's effects.

People. Changes in eligibility standards will lower the number of food stamp recipients by about 5 percent. Though altered deductions will bring in new participants totaling 4 percent of the current caseload, about 9 percent of current food stamp users will no longer be eligible or will drop out of the program due to small benefits. But the expected one-third increase in the participation rate (participants as a percentage of eligibles) will more than offset the reduction. The net impact of these changes should be an increase of 14.5 percent (2.3 million persons) in program participation, swelling program rolls to over 18 million in the 50 states and the District of Columbia. But participation changes will not be uniform across income levels or across regions.

TABLE 1

REGIONAL POVERTY RATES, 1976*

Region	Rate
Northeast	10.2%
North Central	9.9
West	10.5
South	15.2
U.S.	11.8

*Poverty population as a percent of total population.

Source: U.S. Department of Commerce, Census Bureau.

In accordance with reform goals, virtually all ineligible households and dropouts will have incomes above the poverty level. The USDA projects that 80 percent of households with incomes greater than 1½ times the poverty level and about 20 percent with incomes between 100 percent and 150 percent of the poverty level will be eliminated from program rolls. No poverty households meeting other requirements will be disqualified. Moreover, two-thirds of new participants will have gross incomes below poverty lines.

Since poverty income participants will account for a greater share of total participation under the new program, we might expect a shift in the regional composition toward regions with higher concentrations of poverty population (poverty rates). As Table 1 shows, the South's poverty rate is noticeably higher than those of other regions.

Table 2 illustrates the likely effects of program changes on regional participation (percentages are based on currently participating households rather than persons). The changes resulting from modified eligibility requirements have been calculated from USDA projections. The

[1]The USDA's projections reflect the expected impact of only the most major program changes–the EPR, the lowering of net income limits, the elimination of categorical eligibility, the standardizing and limiting of deductions, and the standardizing of the benefit reduction rate.

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TABLE 2

PROJECTED REGIONAL PARTICIPATION EFFECTS PERCENT OF CURRENTLY PARTICIPATING HOUSEHOLDS

	Northeast	North Central	West	South	50 States + D. C.
Current participation	100.0%	100.0%	100.0%	100.0%	100.0%
Changes resulting from eligibility changes:					
Made ineligible	- 10.7	- 9.3	- 12.6	- 5.0	- 8.6
Dropouts	- 0.4	- 0.5	- 0.5	- 0.3	- 0.4
New non-EPR participants	+ 4.0	+ 9.3	+ 5.3	+ 5.5	+ 5.8
Participation after eligibility changes	92.9	99.5	92.2	100.2	96.8
Estimated new EPR participants*	+ 16.3	+ 17.4	+ 16.1	+ 17.5	+ 16.9
Estimated new participation	109.2	116.9	108.3	117.7	113.7

*17.5 percent of "Participation after eligibility changes" expressed as a percentage of current participation.

Source: Calculated from information supplied by the U. S. Department of Agriculture.

additions to the number of food stamp households resulting from the EPR, and thus the total participation gains, have been estimated, however. The USDA has made no estimates of the regional effects of the EPR. But, if we assume that EPR participation increases in each region are a constant proportion (17.5 percent, as nationally) of participation after eligibility changes, the total increases will be as shown by the bottom line of Table 2. Table 3 gives the number of households involved, as estimated from these percentages.

As poverty rates would lead us to expect, participation will increase most in the South, about 18 percent compared to the average of 14 percent for the 50 states and the District of Columbia. And since the South has the largest current caseload, the number of households added will be nearly twice as great as in any other region. The percentage of households eliminated will be lowest in this poorest region and will be offset by new non-EPR participants; other regions will experience net reductions in participation as a result of eligibility changes.

Poverty rates, however, cannot explain all the regional differences in expected participation changes. The percentage rise in food stamp recipients in the North Central region, with the lowest poverty rate, will exceed the national average. To a limited extent, such discrepancies may reflect regional variations in the impact of changes in allowable deductions, particularly the tightening of the excess shelter deduction, whose influence would vary with housing costs and utility bills. Moreover, poverty rates provide only a very rough measure of program eligibility: They reflect gross household income, while food stamp eligibility is determined by net household income. There are no data available on the number of households with incomes just above the poverty level that might be eligible in each region, though some of these households are reflected in the USDA's projected participation increases.

Another source of regional differences in program growth may be participation rates. If the proportion of eligibles participating varies by income level and by region, participation changes may not jibe with eligibility changes. Moreover, if participation rates do vary by region, it may not be reasonable to assume, as we have done in estimating the number of households brought into the program by the EPR, that participation rates will rise uniformly throughout the nation. Though the USDA makes no estimates of participation rates by region, the ratios of food stamp users to poverty population, shown in Table 4, suggest that there may be some regional differences. Of course, many households with gross incomes above the poverty level legitimately receive food

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TABLE 3

PROJECTED REGIONAL PARTICIPATION EFFECTS
(thousands of households)

	Northeast	North Central	West	South	50 States + D. C.
Current participation	1,217	1,114	1,032	2,071	5,434
Changes resulting from eligibility changes:					
Made ineligible	- 130	- 104	- 130	- 104	- 468
Dropouts	- 5	- 6	- 5	- 9	- 25
New non-EPR participants	+ 47	+ 102	+ 53	+ 112	+ 314
Estimated new EPR participants	+ 198	+ 193	+ 166	+ 362	+ 919
Estimated new participation	1,327	1,299	1,116	2,432	6,174
Net change	+ 110	+ 185	+ 84	+ 361	+ 740

Source: Estimated from information supplied by the U. S. Department of Agriculture.

TABLE 4

RATIOS OF PARTICIPATION TO POVERTY POPULATION BY REGION, 1976

Northeast	.80
North Central	.63
West	.63
South	.60
50 States + D.C.	.65

Source: Average monthly participation was calculated from U. S. Department of Agriculture Food Stamp Program statistical summaries; poverty population estimates were supplied by the U. S. Department of Commerce, Census Bureau.

stamps. But the wide range of these ratios and scanty information on regional income distributions lead us to suspect that factors other than income influence regional participation. Whether the EPR will maintain, widen, or narrow any discrepancies in the ratios of recipients to eligibles is unknown. Regional participation rates are a "gray" area of the USDA's projections and could cause actual changes in the number of food stamp households to deviate significantly from expectations.

Benefit Dollars. The USDA projects that annual food stamp subsidies will rise by $412 million, or 8.9 percent of the current benefit level, once the implementation of program changes is complete and the full impact of the EPR is felt. All of the increase will derive from the participation gains induced by the EPR. Tighter eligibility requirements and standardizing the benefit reduction rate would reduce annual benefits by $120 million if the purchase requirement were retained. The regional distribution of benefits under the new program will reflect both participation increases and the redirection of subsidies toward poverty households.

The great majority (about 80 percent) of participants in the new program will be households that are eligible for both the current and the new programs. Table 5 presents projections of the impact of program changes on the benefits received by these "core" households according to the level of household income. A larger share of poverty households will gain benefits, and a smaller share will receive smaller subsidies than the higher income groups. In general, the higher the household income group the larger will be the share of benefit losers and the smaller will be the proportion of benefit gainers. Over half of all households remaining in the program will experience little or no change in their food stamp subsidies, however. Unfortunately, the USDA has provided no estimates of the dollar amounts to be gained or lost in each category. But, in general, the largest benefit increases and the smallest losses will apply to poverty households.

New participants, of course, will be the greatest benefit gainers. Even though they

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TABLE 5

BENEFIT EFFECTS ON HOUSEHOLDS REMAINING IN THE PROGRAM BY INCOME LEVEL

	Gross Household Income			
	Below Poverty Level	100-150% Poverty Level	Above 150% Poverty Level	Total
Households remaining in the program	100.0%	100.0%	100.0%	100.0%
Receive smaller benefits	18.4	33.1	63.6	21.4
No change in benefits*	51.7	55.2	27.3	52.0
Receive larger benefits	29.9	11.7	9.1	26.6
Number of households represented by 100% (000's)	4,044	837	60	4,941

*Gain or lose $5/month or less.
Source: Calculated from information supplied by the U. S. Department of Agriculture.

will be predominantly poverty households, they will generally receive smaller subsidies than current participants. Consequently, average benefits per household will fall to $71.86 per month from the current mean of $75.90. The altered eligibility standards and benefit formula will reduce average subsidies slightly (97 cents a month); the EPR will account for the additional $3.07 per month drop. The reason is that new EPR participants will be primarily households that would have had the larger purchase requirements and, thus, receive the smaller subsidies.

The regional economic impact of food stamp reforms will generally be a function of the distribution of Federal food dollars. In the absence of projections of regional changes in total benefits, the number of households gaining and losing benefits and entering the program for the first time can suggest the direction of new benefit flows (see Table 6). The South will have the most benefit gainers and new participants in both relative and absolute terms. Benefit losers, including households eliminated, will comprise a small percentage of this region's caseload as well. An impact study prepared by the Congressional Budget Office for an earlier version of the reform bill lends support to the conclusion that the South will probably receive the largest chunk of new subsidy payments. Low income levels further imply that the expected decline in average benefits per household may not be as pronounced in this region.

Costs. The EPR and operations improvements should eventually reduce Federal administrative costs by about $25 million a

TABLE 6

REGIONAL BENEFIT EFFECTS
(thousands of households)

	Northeast	North Central	West	South	50 States + D. C.
Eliminated	135	110	135	113	493
Continuing from current program:					
Lose benefits	364	195	229	268	1,056
No change in benefits[1]	619	511	480	958	2,568
Gain benefits	99	298	188	732	1,317
New participants[2]	245	295	219	474	1,233

1 Gain or lose $5/month or less.
2 Includes estimated new EPR participants.
Source: Estimated from data supplied by the U. S. Department of Agriculture.

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year, offsetting some of the expected rise in benefit costs. The USDA projects a net addition of $387 million a year to total Federal food stamp outlays. Furthermore, the Food Stamp Act of 1977 places ceilings on congressional appropriations for fiscal years 1978-81, the life of the new program, and provides for benefit reductions if costs threaten to overrun the limits. If participation increases are even slightly larger than projected or economic conditions are not as favorable as assumed, a lowering of subsidy levels is a very real possibility.

Administrative expenses of the states should also fall. Not only will the EPR and simplifications of operations save them money but Uncle Sam will step up reimbursements for their contributions to administration of the program.

IMPLICATIONS

What kind of economic impact can we expect from directing a greater amount of Federal dollars to a larger number of the nation's poor? The general effect will be a redistribution of income, which should result in some improvement in the living standards of low income households. Moreover, food stamp recipients as a group will be able to purchase not only more food but more of other commodities as well. The money that participants would have used to purchase food stamps will be freed for other uses by the EPR. In fact, less may be spent for food under the new program than under the current program. Including purchased stamps, the USDA currently issues well over $7 billion of food coupons annually. The EPR will reduce distribution to less than $6 billion a year, even with the large expected participation increases. Uses of the discretionary cash will determine the type of sales which will benefit. Thus, even though the increase in annual program outlays of less than one-half a billion dollars will not pack much of an economic punch, the freeing of $1 to $2 billion a year for discretionary purchases may disperse the stimulus of Federal food stamp expenditures to a wider range of commodities.

The South, as we have seen, is likely to be the most strongly affected by this economic stimulus. Regional differences in income levels and prices may enhance the participation and benefit effects of the new Food Stamp Program on the region's "real" living standards. Since national averages determine the income limits for program eligibility, below-average income levels are largely responsible for expectations of above-average participation growth in the South. But since its prices are generally lower as well,[2] many new southern participants may already be better off (have greater purchasing power) than their counterparts in other regions and their new benefits may go further.

Inflation could either erase or broaden any such disparity. Food stamp benefit levels, income limits, and deduction ceilings will be periodically adjusted to reflect changes in national price indexes. Regional inflation rates and wage increases (as well as levels) often differ from national averages, however. If income levels rise more rapidly in the South than in the nation as a whole (as they have in recent years), a disproportionate number of southern participants could be disqualified despite adjustments to income limits. And if prices continue to rise more rapidly in the South, an elevation of the benefit level according to national inflation will not entirely prevent erosion of purchasing power. ■

[2]For evidence of lower prices in the South, see "Cost-of-Living Comparisons: Oasis or Mirage?" by James T. Fergus, this **Review**, July/August 1977.

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SIXTH DISTRICT BANKING NOTES

The Recent Strengthening in Real Estate Lending

Since the first of this year, the District's 32 largest commercial banks have been adding real estate loans to their portfolios at an annual rate of nearly 17 percent. In contrast, business loans have been advancing at an annual rate of about 13 percent and total loans more slowly, at an 11-percent annual rate. Real estate loans have accounted for about one-third of the dollar growth in total loans so far this year.

Renewed interest in real estate loans on the part of the large banks and their consolidated real estate subsidiaries follows a period of about two years in which real estate loans were very much out of favor. From 1971 through 1973, real estate loans had surged nearly $1.5 billion and growth had averaged over 30 percent a year. But in 1974, recession hit the real estate industry and many large banks experienced severe problems with their direct real estate loans and loans to firms financing the real estate industry. Loans involving construction, land development, and various types of commercial property, the most rapidly increasing real estate loan category in the early '70s, inflicted heavy losses at certain banks. Some borrowers defaulted; others were allowed to delay, defer, or make reduced interest payments. Some banks took title to real estate directly through foreclosure, agreement with borrowers, or asset swaps with other financial institutions. Foreclosures were especially troublesome at larger banks in Georgia, Tennessee, and Florida. As a result, banks' real estate holdings other than their premises increased by over $200 million and earnings declined sharply at many large banks.

Some of the recent strength in real estate lending can be attributed to locally weaker business loan demand. In three of the District states—Tennessee, Mississippi, and Florida—there has been above-average growth in real estate loans but business lending has been relatively weak. The sluggish business loan demand may have encouraged these banks to seek additional real estate loans in order to expand loan volume. However, the strongest growth in real estate loans this year has occurred at the large Alabama banks, where business loans have advanced nearly twice as rapidly as in the remainder of the District. This part of the region generally escaped the earlier real estate problems. Large banks in Louisiana have also had above-average growth in both real estate and business loans. At the larger banks in Georgia, where corporate loan demand has exceeded the District pace, real estate loans have continued to decline.

There are several reasons District banks are again actively financing real estate. Although business loan demand is stronger now than it has been since 1974, it is probably lower than many bankers expected. With adequate deposit gains, many banks have sought the higher yields of loans instead of the lower returns of short-term securities. Also, real estate markets around the District have improved significantly from their depressed levels of the recession. New projects once again seem financially viable.

During the first half of 1977, real estate loans to finance commercial properties have accounted for over one-half of the increase in real estate loans, with the strongest gains at the larger banks in Tennessee, Georgia, and Florida. This development is a little surprising, since these same states were most severely impacted by problem loans of this type less than three years ago. Loans to finance construction and land development, although essentially unchanged in the District as a whole, have been rising quite strongly at the larger banks in Alabama and Louisiana. Conversely, banks in Georgia and Tennessee are still reducing their real estate loans for such projects.

Residential mortgage loans, which account for nearly one-third of the large

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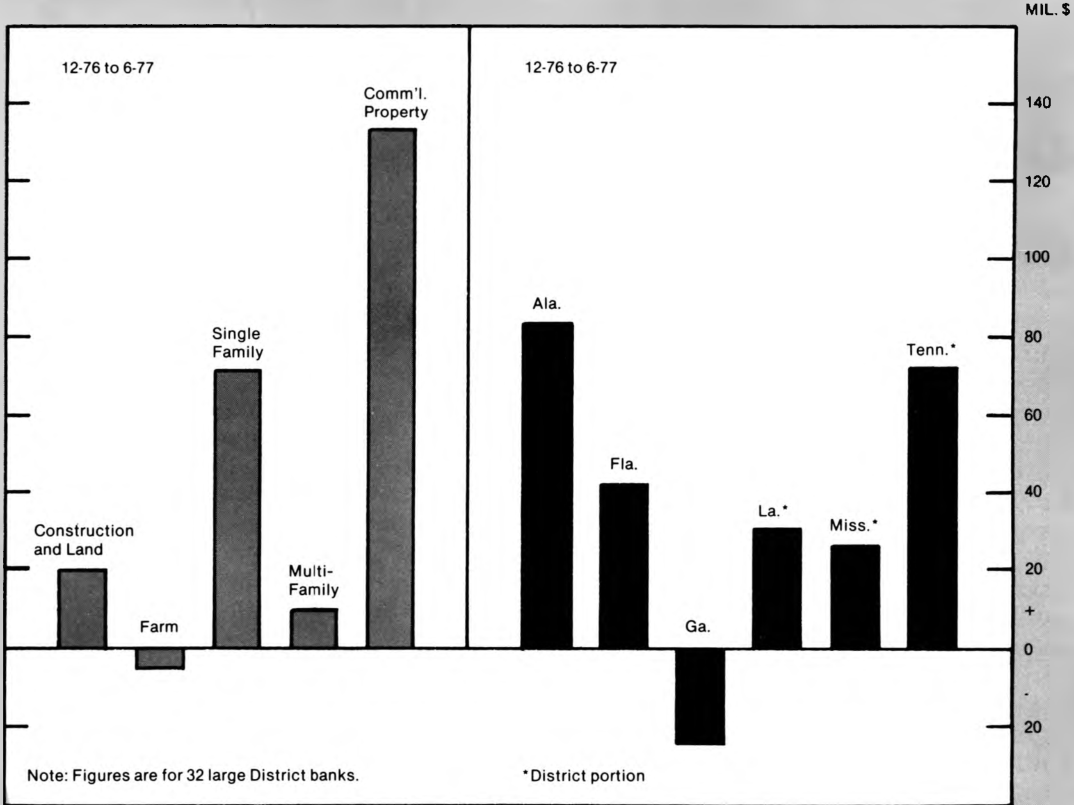
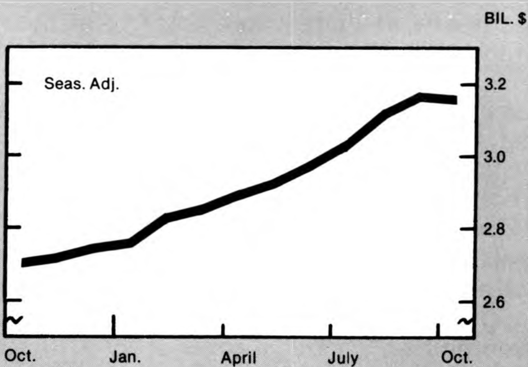


banks' total real estate loans, have grown at a faster pace than total real estate loans. Single-family mortgage loans have advanced most rapidly in Alabama and Florida. District banks are not major lenders for multifamily residential properties, and all growth in this area has come in Tennessee and Florida.



The recent strengthening in real estate loans at the larger banks suggests that many of these institutions feel that they have overcome the real estate-related difficulties of the last recession and that real estate financing is more readily available. It is also a sign that real estate markets have revived and that new projects are moving from the drawing board to the development and marketing stages. If the region's largest banks can draw on their previous experiences with the consequences of rapid real estate loan growth, this revival can be taken as a good sign for the banks and the region. Hopefully, recent advances will not result in a replay of earlier excesses.

John M. Godfrey

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RESPONSE TO COUNTYWIDE BRANCHING

THE NEW CHAPTER IN FLORIDA BANKING

by Ruth Goeller

In our 1975 assessment of Florida banking structure, we observed that the rapid proliferation of new bank holding companies had almost run its course and that subsequent changes were likely to come in response to amendments to Florida banking laws which have recently been enacted.[1] Specifically:

> "Any bank may establish up to two branches per calendar year within the limits of the county in which the parent bank is located and, in addition, may establish branches by merger with other banks located within the county in which the parent bank is located."[2]

Until the amendment took effect at the beginning of 1977, Florida was essentially a unit banking state. A 1973 law did permit each bank one limited facility for accepting deposits and loan payments within one mile of its main office, but mergers and branch offices were prohibited.

The new law broadened these limits considerably, providing two types of branching opportunities. First, each bank is now allowed to establish up to two branches per year in its own county, subject to the approval of designated state and national regulatory authorities. During the first seven months of 1977, seventy-six full-fledged branches were established under this authority.

The second newly available branching opportunity is more complicated: Two or more banks in the same county can merge, with regulatory approval, into a single bank as a head office and one or more branches. This opportunity was expected to be particularly appealing to banks already under the common control of a multibank holding company, since approval by the banks themselves is simplified in such a case. Although commonly owned banks are often operated much as a branch system, merger would permit the full benefits of branch bank organization.

In this state, where branching has previously been precluded, where holding company development has already consolidated control of many banks into single organizations, where rapid population and income growth has elevated the demand for bank services, and where competition is strong from thrift institutions, which can branch statewide, what has been the response to the new law? And, more importantly, why has it been what it has? Over and above our obvious interest in Florida's changing banking structure, this offers a case study of banks' response to a new legislative opening.

What happened? The new opportunity for countywide consolidation of holding company affiliates, so attractive in theory and to the amendment's proponents, has been used less than many anticipated. Out of Florida's 29 holding companies which have eligible affiliates, 15 have actually used the eligibility in the first seven months of this year. Forty-four new branches were created by merger of existing affiliates, twenty of which were effective by the end of January. Including applications pending approval as of September 1, 1977, a total of 99 affiliated banks have asked to be converted to branches. Our records indicate that 206 other Florida banks which are eligible for

[1] B Frank King, "Banking Structure in Florida," this **Review**, September 1975, pp. 142-147. For an earlier perspective, see Charles D Salley, "A Decade of Holding Company Regulation in Florida," this **Review**, July 1970, pp 90-97.
[2] Florida Statute 659 06(1)(a)1

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conversion have not applied. Roughly one-third of the potential conversions have been attempted, in other words.

This contrast between the number of merger applications and the number of potential mergers indicates that conversion of banks to branches may not be as attractive to Florida bank holding companies in reality as it was in prospect or that conversion has been impeded for other reasons. Several possibilities may be suggested:

1. Potentially unfavorable reactions from the personnel of the merged bank might, at best, require careful long-term planning or, at most, discourage the merger altogether. Redesignations of bank presidents as branch managers, for example, would probably not be well received.
2. Similarly, since a branch bank does not need a board of directors, directors of the merged bank would have to be added to the parent board of directors or to an advisory board, if bylaws permit, or dropped. Hesitation to displace these directors, who are typically prominent community leaders, could deter mergers.
3. Merging the accounting functions and records of banks involved might require several months to plan and coordinate.
4. Any bank merged before it has exercised its new option to establish two branches in any given year forfeits that option. It may be that bank holding companies have been postponing mergers to maximize branch proliferation.

To check out these possibilities, we contacted officers in charge of acquisitions and expansion at six Florida holding companies. Three of these officers represent holding companies which had not submitted applications to merge at the time we talked to them. The other three officers represent holding companies which had submitted merger applications. We asked each officer what he regarded as the main incentives to convert banks to branches and his company's future plans with reference to the merger option. Where appropriate, we questioned each officer about the impediments hypothesized above.

The banks were basically in agreement. The holding companies which had not yet done so were indeed planning to submit applications to merge certain affiliates. All holding companies agreed that there were economic incentives for converting affiliates to branches. One officer told us that cost studies his holding company had prepared indicated that merging ten banks in three counties would save the organization $375,000 a year "overall," based on 1977 expenses.

The contention that branch operation provided better customer service was the second most frequently emphasized incentive to merge. The bankers saw a competitive advantage in the ability to offer a customer the same service at any county location with records consolidated on on-line equipment. Others mentioned that arranging loan participations was somewhat more complicated among affiliates than among branches. One representative stated that branches would offer customers the services of parent banks more readily than affiliates would offer the services of other affiliates. Another felt that consolidation of management in one place would speed and improve communication within the bank, thus improving bank service.

Since most bankers told us they had determined that converting unit bank affiliates to branches was competitively advantageous, most of our questions about "reasons not to merge" were answered in terms of "difficulties to overcome." All six bankers confirmed that considerable care, long-term planning, and diplomacy had been or would be expended in making merger-related changes in managements and boards of directors. In fact, bank holding company officers speculated or confirmed that the first conversions made were among banks where close affiliation had already created management and/or board overlaps that minimized disruption of the organizational hierarchy in consolidation. Some bankers described programs developed by their organizations to show why consolidation was desirable, to dispel employees' fears about the change, and to demonstrate how branching could

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enhance career opportunities. One banker mentioned the coincidence of some "timely resignations" with the announcement of his holding company's merger plans. Another officer indicated that future promotions in his holding company would probably be made with reference to the employee's current duties and his likely position in the merged bank. It is clear that the potential impact on the people involved is a major factor in holding companies' consolidation plans.

The mechanical adjustments necessary for consolidation—the merging of the general ledger and related accounting functions—appear to have gone or are expected to go much more smoothly and easily than the personnel adjustments. When consolidation requires change in the calculation of interest on savings or when duplication of account numbers in the consolidated files requires customer notification, an additional 30 to 90 days may be needed to coordinate bookkeeping. In some situations, similarity of operating techniques and accounting methods among merged banks made the transition easier. One officer told us that physical merger of the general ledger was done overnight but was a major headache. None of these bookkeeping problems were viewed, however, as a major reason to delay submitting merger applications.

In answer to questions about factors which could be delaying mergers, nearly every banker we interviewed speculated that perhaps other holding companies were waiting to determine whether a county's projected growth rate and customer demand opportunities justified use of the full branch potential of the affiliate before applying to merge it. In Florida's fastest growing counties, this may be a reasonable contention. ■

CONVERSION AND FED MEMBERSHIP

One interesting by-product of this merger conversion process may be expansion of the deposit base subject to Federal Reserve requirements. Banks affiliated with registered Florida bank holding companies vary in membership status. On the whole, however, the larger banks tend to be members of the Federal Reserve System. If every holding company in Florida which has affiliates eligible for conversion should use that eligibility, merging the smaller affiliates into the largest affiliate in each county while maintaining the largest affiliate's membership status, then $1.3 million in deposits would shift from nonmember to member banks (according to mid-1977 deposit levels).

Most discussions of Federal Reserve membership changes focus on membership costs and benefits. Here, however, is a case where membership patterns may change significantly for another reason.

So far, this has not happened. Current membership data indicate that as of September 1, 1977, eleven nonmember banks are pending merger into member banks. Six member banks would be merged, upon approval, into nonmember banks. Two of these members are smaller than the nonmember into which they will be merged; four will be merged into smaller nonmembers. But earlier mergers show that the predominant pattern followed by holding companies in consolidating affiliates is merger of the smaller affiliate into the larger. Although our statistics do not yet reflect a membership gain, a continuation of that trend should increase the volume of deposits subject to member bank reserve requirements.

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WORKING PAPER ABSTRACTS

The following articles summarize staff analyses that may interest those in the economics and banking professions as well as others. They are more technical than the typical Economic Review article. The analyses and conclusions are those of the authors. Studies of this kind do not necessarily reflect the views of the Federal Reserve Bank. Each complete study is available as part of a series of Federal Reserve Bank of Atlanta Working Papers. Single copies of these and other studies are available upon request to the Research Department, Federal Reserve Bank of Atlanta, Atlanta, Georgia 30303.

FUNDAMENTAL DETERMINANTS OF CREDIT VOLUME: A SURVEY AND REGIONAL APPLICATION

by Robert E. Keleher

There has long existed a confusion between credit and money in the history of monetary analysis. Whereas some economists contend that no important difference exists between money and credit, others draw a sharp distinction between the two. This confusion has had some important consequences, particularly with respect to the analysis of credit. In many cases, for example, credit has been treated as if it were synonymous to money and, therefore, its volume has been assumed to be determined by the Federal Reserve, even in relatively short-run time frames. This study is an attempt to clarify some of the issues regarding the fundamental determinants of the volume of credit as distinct from money and to present empirical evaluation of credit determinants.

In general, two positions regarding the short-run determinants of the volume of credit in a large, closed economy have evolved from the extended confusion. One view is that money and credit behave in a similar fashion and the same analytical treatments are appropriate for each. An implication of this position is that changes in both money and credit precede and are determinants of movements in nominal income. That is, the transmission of monetary impulses runs from changes in the volume of money and credit to changes in expenditures and income. Moreover, the main channels of monetary effects on the economy are the credit flows through financial institutions. Movements in credit volume, according to this view, are essentially determined by supply factors.

Another position maintains an important distinction between money and credit. Accordingly, proponents of this view contend that the volume of money and the volume of credit behave differently over the business cycle. Although changes in the volume of money precede movements in income, changes in the volume of credit may follow changes in income. That is, the volume of credit may be influenced to a larger degree by demand factors than is the volume of money. In this case, the transmission of monetary impulses runs from changes in the volume of money to changes in income to changes in the volume of credit. Credit, then, is a derived demand or demand-determined.

When the determinants of the volume of credit are examined in the context of the small, open economy, the position that credit is demand-determined receives additional support. Recent theoretical work on the monetary aspects of the balance of payments concludes that the volume of credit in a small, open economy is determined by demand factors and not necessarily those of supply, as might be the case in a large, closed system. In short,

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the determinants of the volume of credit in a small, open economy may differ from those of a large, closed economy.

After examining previous empirical studies related to these various arguments, this study provides some preliminary empirical evidence of the determinants of regional loan volume, i.e., credit in a small, open economy. Applying elements of the monetary approach to the balance of payments to an open regional economy, an estimating equation incorporating both national supply and regional demand factors was developed. Data on national reserves, Sixth Federal Reserve District loans, and regional and national income were used to test the relative importance of national supply and regional demand determinants of loan volume. The empirical evidence indicates that regional demand plays a more significant role than national supply factors in explaining the growth of regional loans. Thus, whereas aggregate (national) credit volume may be influenced to some extent by the monetary authority, the distribution of that volume of credit among regions apparently is demand-determined. ■

A FRAMEWORK FOR EXAMINING THE SMALL, OPEN REGIONAL ECONOMY: AN APPLICATION OF THE MACROECONOMICS OF OPEN SYSTEMS

by Robert E. Keleher

One area of research conducted at Federal Reserve District banks is the examination of relationships between real variables of the region and financial variables under the influence of the central bank. While some markets affecting the regional economy are clearly national markets, others are influenced by the peculiar characteristics of the region. Unfortunately, there are several reasons why most theoretical frameworks commonly employed to analyze regional economies have not been particularly useful for analyzing interactions between the monetary and real dimensions of regional economic activity.

This Working Paper describes an alternative theoretical framework for the examination of monetary and credit variables of the small, open regional economy. Recently, a considerable amount of theoretical work in monetary economics has been devoted to analyzing small, open economies. Specifically, the monetary approach to the balance of payments, or the so-called "global monetarist" school, offers some unique and interesting insights into the economic analysis of the small, open economy (SOE) and, in particular, clarifies its monetary and credit dimensions.

The global framework and its propositions are by no means new theoretical positions. Rather, they represent a return to an older, pre-Keynesian approach to monetary analysis. The global approach essentially examines the small, open economy within a closed world framework. Whereas most familiar monetarist propositions apply to the closed world system, they do not necessarily pertain to the small, open economy within the larger global aggregate.

The balance of payments must be taken into consideration when shifting from a closed to an open analytical framework and as one examines an economy which constitutes a relatively small proportion of the aggregate of which it is a part; other considerations are relevant as well. Propositions of the global approach rest on the "law of one price" and the assumption that the small, open economy is too small in terms of both production and consumption to influence either world prices or interest rates. Thus, interest rates and prices (inflation) in the SOE are determined in world markets and, therefore, are given exogenously to the SOE. Based on this contention, the global approach draws some important conclusions regarding the functioning of

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the SOE that differ quite radically from contemporary models of closed economies.

After describing alternative versions of the "global" approach, the paper argues that the proper framework for analyzing the small, open regional economy is one analogous to the global monetarist framework. Since the U. S. economy is large enough to warrant analysis as a closed economy, it can assume the role of the closed world economy in the normal global framework. The regional economy, then, can be analyzed as a small, open economy within the larger, closed national framework. The particular version of the global framework pertinent to the small, open regional economy is the fixed exchange rate version, since the monetary environment of the regional economy is analogous to that of a small, open economy in a common currency area. In addition to having some important empirical advantages, this particular framework may be even more applicable to the contemporary regional economy than to contemporary national economies. Many of the critical assumptions upon which the theory rests are more in accordance with the actual circumstances of the regional economy than they are with the national economic environment. For those interested in analyzing the regional economy, the regional dimensions of money and credit markets, the regional transmission of monetary policy, or the various interrelationships between real and financial variables of the region, the global model offers some important insights and conclusions that differ from those models commonly employed to examine the regional economy. ■

HOLDING COMPANY POWER AND MARKET PERFORMANCE: A NEW INDEX OF MARKET CONCENTRATION

by David D. Whitehead

In the late 1960s, multibank holding company acquisition activity began to accelerate and, consequently, became a new element in the structure of the commercial banking industry. As an organizational form, the multibank holding company approximates statewide branch banking in that it allows one organization to actively compete in a number of geographically dispersed banking markets. These two forms of banking organizations (statewide branching and multibank holding companies) have created analytical problems in assessing the competitive conditions within relevant geographic banking markets. Concentration ratios have traditionally been used as predictors of a market's competitive performance. Concentration measures applied to the banking industry have not taken account the presence of multimarket organizations in a given geographic market. Subsidiaries of multimarket organizations may enjoy increased market power as a result of their affiliation with a larger financial organization. If the presence of multimarket organizations significantly affects competition within banking markets, then our traditional measures of market structure are inadequate.

The purpose of this paper is to expand our knowledge on this question by adapting and testing a measure of market concentration which takes into account the presence of multimarket organizations in local banking markets. The Herfindahl Concentration Index, a conventional measure of concentration, is modified by a "booster coefficient" to reflect the presumed additional market power of banks which are subsidiaries of multimarket organizations. The "booster coefficient" reassigns market shares by

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proportionately reducing the shares of independent banks and increasing the shares of banks belonging to multimarket organizations. The hypothesis that subsidiaries of multimarket organizations enjoy increased market power is based on the assumption that the larger parent organizations are able to offer their subsidiaries increased financial strength, increased management talent, scale economies, and various other benefits which make their subsidiaries more competitive. The "booster coefficient" is a function of the size of the multimarket organization, the relative size of the subsidiary of the multimarket organization in the given market, and the size of the market. The basic hypothesis tested in this study is whether a concentration index which takes account of multimarket organizations will give a better measure of market structure than those measures currently being used. To test this hypothesis, we compared the predictive powers and statistical significance of the "boosted" index with those of five alternative concentration measures which do not account for the presence of multimarket organizations.

The new index of market concentration and a set of five conventional concentration measures were calculated for each of the 130 banking markets in the Sixth Federal Reserve District, as designated by the Board of Governors of the Federal Reserve System. A general regression equation is specified and used to hold constant a set of six independent variables which proxy market supply and demand conditions. A set of eight market performance variables is then specified—three price variables, three efficiency measures, a profit measure, and a resource utilization measure. The standard regression equation is then estimated six times for each performance variable, changing only the market structure measure.

An analysis of the significance and predictive powers of the new index compared to the five standard measures of market concentration indicated that the new measure is a better predictor of the unregulated market price variable (average interest charged on loans). In addition, the new index proved to be significant where any of the other five conventional concentration measures proved significant, except in predicting the regulated price variable (average rates paid on time and savings accounts). The study concludes that multimarket organizations and other outside market forces are important in explaining market performance in banking. ■

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