

# **Voice**

**of  
the Federal Reserve Bank of Dallas**

**El Paso · Houston · San Antonio**

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# **The Control of Inflation**

**By**

**Ernest T. Baughman, President  
Federal Reserve Bank of Dallas**

**at the**

**Texas Farm and Ranch Credit School  
for Commercial Bankers  
Texas A&M University  
College Station, Texas**

**February 12, 1979**

The American economy will be subjected to severe stresses during 1979 and for some time thereafter. Normally, that should not be a matter for concern. Stress should be taken in stride by any economy that is reasonably flexible and dynamic. And of all the economies in the world, the "free enterprise" economy of these United States should demonstrate a capacity for flexibility and dynamism beyond any other.

I know of no economic theory or concept that would preclude our achieving our basic economic goals on an ongoing basis, namely, full employ-

ment, price stability, economic growth, and balance in international payments. But to achieve these goals on an ongoing basis, our economy must possess substantial flexibility; it must have the capacity to generate and respond to an ongoing flow of change; it must be peopled by individuals and governed by a government willing to accept, even promote, change and adaptation to change.

I am gravely concerned that the American economy will not achieve its potential in 1979 or 1980 or 1981 or ———. I seriously doubt that we will successfully digest the stresses to which we will be subjected. I am concerned because I see mounting evidence that we are increasingly enlisting the strong arm and the long purse of government to rheumatize the economy, thereby reducing its flexibility and, hence, its capacity to digest stresses and strains and, consequently, its capacity to achieve and maintain full and productive utilization of our resources.

For many years we appear to have been fumbling around in a halfway house between a free enterprise economy that is primarily market-directed and an economy that is primarily government-directed and -controlled. On balance, we have moved and still are moving to greater government control but without any overall concept, strategy, or plan as to how to manage a government-controlled economy. In many respects our



words and our actions are contradictory. All too often we—

- Talk economic growth but act to restrict production;
- Talk free markets but act to restrict competition;
- Talk price stability but pass laws that directly raise prices;
- Talk full employment but pass laws and impose regulations that directly increase unemployment;
- Aspire to be rich but act to denigrate saving and investment;
- Label inflation public enemy number one but fail to attack it from all quarters.

We should not be surprised that individuals and groups of individuals with common interests seek to escape the very impersonal discipline that flows from competition and market-determined prices. But we should be concerned that such efforts are encouraged, augmented, and accommodated by inscribing laws and regulations that serve such desires and do this by eroding the effectiveness of competitive market processes, for it is these competitive market processes that integrate and coordinate economic activity. There are better and more effective means to serve such interests, insofar as it is determined via accepted political processes that they are to be provided rewards in excess of those provided by the marketplace.

I am much impressed with the proliferation of anticompetitive "structural" or "institutional" aspects of our economy. I am concerned that structural and institutional developments have deprived conventional monetary and fiscal policies of much of their perceived capacity to nudge the economy along the path of full employment and price stability. It is these structural and institutional characteristics of the economy that give credibility to the view that it will take a long time to get rid of inflation. Unfortunately, they give substance also to fears that we may not get rid of it at all.

I seriously doubt we will wring inflation out of our economic fabric through the use of monetary and fiscal policies alone, precisely because it would take so long. That is, I seriously doubt that a slow and easy strategy can be adhered to long enough to solve our inflation problem. Even in the event we were to accept some increase in unemployment and relatively slow growth in order to achieve a gradual decline in the pace of inflation for the five to ten years this strategy is estimated to require to achieve price stability, there is no reason to be-

lieve it would be a sustainable situation unless we had effectively addressed the structural and institutional problems in the interim.

The presence of structural and institutional problems largely reflects dissatisfaction with income allocations flowing from the marketplace plus the ability to take actions through public or private institutions to enhance them at the expense of other sectors. Such dissatisfactions, like death and taxes, are ever present. Unless the anticompetitive paraphernalia accumulated from these circumstances are washed away, and the proclivities to install new ones are circumscribed, monetary and fiscal policies intended to promote full employment would soon generate inflation again.

There are few encouraging signs about. The substantial move toward deregulation of the airlines is most encouraging. The beneficial results are supportive of other similar actions. The President's recent declaration that he will propose legislation to deregulate other types of transportation is most welcome. Judicial opinions that call to question restrictive practices of certain professional and trade associations can have significant beneficial effects if pursued and extended to other areas. The popularization of the proposition that the economy is overregulated could bear fruit in many sectors if it leads to appropriate actions. However, while these favorable changes have been taking place on one hand, we have, on the other hand, proliferated regulation of energy at an amazing pace, restricted imports of many commodities, increased minimum wages and employment taxes, raised prices and restricted production of agricultural commodities, required heavy investment in environmental and safety programs (the benefits of which, in some instances, probably have been small relative to cost), laid a heavy layer of additional regulation on financial institutions.

On balance, structural and institutional elements probably will continue to accelerate, not attenuate, inflation in 1979. This is a tragic situation. It is tragic that the real value of the medium of exchange is continuing to decline and, along with it, the real value of many of the dollar-denominated debt instruments that constitute the major assets of many families. As families have gradually lost confidence that the economy will be managed effectively, they have increased their debts even at rising interest rates and reduced savings relative to income.

Monetary policy will be shaped during 1979 to constrain bank credit and monetary growth rates



to levels deemed supportive of moderate growth of employment and production and restrictive of inflation. But monetary policy cannot determine whether credit and money will be used to finance increases in production or increases in prices. That will be determined by the efficiency with which labor, commodity, and credit markets function. The serious structural and institutional constraints on competition and price and wage flexibility, unfortunately, probably will mean that monetary "restraint" can at best bring only modest slowing of inflation in 1979. In fact, monetary restraint may not buy substantial slowing of inflation unless we

do move to get rid of some of these anticompetitive constraints. A "cure" for inflation that requires the virtual cessation of growth for a number of years may not be an acceptable alternative. Fortunately, it is not the only alternative. With a reduction in these institutional and structural constraints, the "cure" could be accomplished in a shorter period of time. If this cannot be accomplished, then we may be doomed to follow in the path of other nations that have lost their national vigor and flexibility as they have sought "refuge" from the economic discipline of the impersonal marketplace in the "friendly embrace" of government regulators.

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## **Functional Cost Analysis Program Offered in 1979**

The Functional Cost Analysis Program, a cost accounting service available to member banks, will be offered again in 1979, for the 14th consecutive year, by the Federal Reserve Bank of Dallas.

Functional cost analysis provides participating banks with earnings and cost figures for 13 of their major bank activities, including demand deposits, instalment loans, and time deposits. Average data are also developed to allow banks to rate their performance against that of similar-size competitors.

Banks interested in participating in the 1979 program should contact the Technical Assistance Division, (214) 651-6370.

# “Fed Quotes”

Brief Excerpts from Recent Federal Reserve Speeches, Statements, Publications, Etc.

“Floating exchange rates, of course, have been long advocated as the ultimate protection against balance-of-payments discipline for all countries. With a floating exchange rate, it was argued, each country could pursue the domestic policies it wanted. Differences in the degree of expansion and inflation would be taken care of by the exchange rate.

“Experience with floating rates has not fully confirmed this prescription. Floating rates have had many advantages, as alternatives to controls, and as a vehicle for a rising volume of international trade and capital movements. But countries that believed they could escape balance-of-payments discipline by floating soon found out otherwise. Overshooting of exchange rates, accelerated inflation, vicious circles, and continuous narrowing of the room for fiscal and monetary maneuver have been the lot of countries that ignored their balance of payments. These consequences of floating have been more apparent in countries with high degrees of openness. The basic conclusion, however, applies also to the United States. Floating rates provide shelter from balance-of-payments discipline only in moderate degree.”

“Diminished reliance on the reserve role of the dollar seems appropriate to me. U.S. experience has shown that, relied upon excessively, a reserve currency role can backfire. It has advantages when not used heavily and particularly when kept in reserve for difficult periods. As a steady diet, the resulting lack of balance-of-payments discipline runs a very serious risk of undermining the strength of the currency.”

Henry C. Wallich, Member, Board of  
Governors of the Federal Reserve System  
(Speech in New York, New York, January 4,  
1979)

“Our nation has paid a heavy price for its having given inadequate attention to the need for business investment. Our capital stock has not grown as rapidly as our labor force in recent years, and this has played a major role in the poor performance of productivity. Over the past five years, annual gains in output per hour in the nonfarm business sector have averaged less than 1 percent as compared to 1<sup>1</sup>/<sub>2</sub> percent in the preceding five years—and 2<sup>3</sup>/<sub>4</sub> percent during the first two decades of the postwar period. This slowdown has retarded the rise in living standards and has aggravated our inflation problem through its adverse impact on unit labor costs. We should set our sights on achieving substantially higher levels of business investment in the years ahead.”

G. William Miller, Chairman, Board of  
Governors of the Federal Reserve System  
(Before the Committee on the Budget, U.S.  
House of Representatives, January 25, 1979)



# New Savings Bonds to Be Issued by the Treasury

The Treasury Department will begin offering two new savings bonds—Series EE and Series HH—in January 1980. The new series will replace the current E and H bonds.

The new EE bond will have a \$50 minimum denomination and a purchase price of 50 percent of its face value. Compared with the E bond, the interest rate of the EE bond (when held to maturity) remains at 6 percent, but the term of maturity will be extended to 11 years and 9 months. The EE bonds will be eligible for redemption six months after issue.

The new HH bond, like the current H bond, will be sold for face value, either for cash or in exchange for other savings bonds and notes. It will pay interest semiannually at a rate of 6 percent, rather than according to the H bond's graduated scale. The HH bond will have the same maturity period as the H bond—ten years—and the same denominations, which range from \$500 to \$10,000.

Series HH bonds purchased for cash, rather than through the exchange of other bonds and notes, will be subject to an interest penalty if redeemed before maturity.

Outstanding E bonds that were bought between 1941 and April 1952 and H bonds bought from June 1952 through May 1959 will not be extended when their present life expires. Series E bonds purchased after April 1952 and Series H bonds purchased after June 1959 will receive one final ten-year extension when their present life expires.

Present E and H bonds will continue to be sold at banks and other savings institutions until December 31, 1979. Payroll sales of the new EE bonds will be phased in effective January 2 to June 30, 1980.

For additional information about the bonds, contact the Fiscal Agency Department of this Bank, (214) 651-6364.

# Corporations Report Improvements in Eleventh District Banking Although Borrowings Have Slipped

By Edward L. McClelland

The southwestern economy has experienced rapid, broad-based expansion in recent years, and this has been both reflected in and supported by rapid growth in banking. In the Eleventh Federal Reserve District, total deposits at all commercial banks rose 72 percent to about \$66 billion from the end of 1972 through 1977. That was substantially greater than the 52-percent increase for the nation. At the same time, total loans (net of interbank loans) expanded 81 percent to \$40 billion, compared with a 63-percent increase for the nation. Accompanying this strong growth of southwestern banking were a number of changes in structure, the most striking being the rapid development of multibank holding companies in Texas. Also, competition among banks and between banks and other depository financial institutions apparently warmed up appreciably.

Much of the growth in banking in the District was due to the expansion of business activity in the Southwest. Annual sales of the 256 largest non-financial corporations headquartered in Texas totaled more than \$83 billion in 1977. That was more than double the sales volume reported by the same number of comparable firms five years earlier.

In light of the fast growth of the economy and banking, the ongoing structural changes in banking, and shifting competitive relationships, questions have been raised as to whether the quality of banking services has kept pace. It is difficult to

measure quality of banking services. However, it is fairly easy to obtain bank customers' views on the quality of banking services. In an area experiencing rapid economic growth, the quality of banking services may be especially important to treasurers of business firms. Also, business managements may be particularly sensitive to changes in the banking services.

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Last fall, this Bank conducted a survey of treasurers of the largest publicly held corporations in the Southwest to obtain their views on quality of banking services. Financial, electric utility, and political corporations were excluded because their credit requirements vary greatly from those of other industries producing goods and services.

The survey focused largely on the share of total borrowing of southwestern companies at District banks. But it also sought to determine the purposes for which firms borrow, important sources of funds



other than banks, reasons for obtaining banking services outside the Eleventh District, and the proportion of total deposits corporations placed with District banks. Finally, respondents were afforded an opportunity to make other observations on quality of banking services.

### **The survey**

Altogether, 374 firms were surveyed.<sup>1</sup> Although the median-size firm had annual sales of \$74 million (1977 dollars), firms in the sample ranged from \$10 billion to \$6 million in annual sales.

The corporations surveyed were ranked by firm size, largest to smallest, measured in sales. The firms were also classified by principal line of business, using the Standard Industrial Classification of the U.S. Office of Management and Budget, since the use of banking services was thought to vary by

type of business as well as size of firm. For example, credit requirements for an oil drilling company may be quite different from those for a retailer.

Thirty days after the initial mailing of the survey questionnaire, 170 corporate treasurers, or 45 percent, had responded. A second mailing to nonrespondents resulted in 77 additional responses, raising the total to 247, or 66 percent.

The response rate was fairly evenly distributed by firm size except for the smallest firms, where it was lower. For example, 54 percent of the firms with sales below \$27 million responded, compared with the 66-percent response rate for all firms.

The responses received from the initial and follow-up mailings were analyzed separately to see if there were any differences between the two groups. The corporations that replied to the second mailing were found to borrow from nonbank sources a bit more than the first group, possibly indicating that if all firms had responded, the data would show somewhat greater use of nonbank sources of credit by southwestern corporations. No other significant differences were detected. This, along with the high response rate, provided the basis for the belief that the respondents were fairly representative of all firms surveyed.

The survey questionnaire consisted of ten questions. The first three were qualitative and allowed respondents simply to check an appropriate an-

1. These included 256 nonfinancial, non-electric-utility firms listed in "Texas Public Company Review," *Texas Business & Texas Parade*, July 1978, pp. 35-40; 54 firms in the top 350 corporations in Texas, from *Texas Parade*, July 1977, pp. 30-46 passim; and 75 firms listed in *The North American Register of Business and Industry*, 1977-78 ed. (Tarzana, Calif.: Global Marketing Services, 1978). The last added a significant number of nonmanufacturing firms and was the source of firms located in the Eleventh District portions of Louisiana, Oklahoma, and New Mexico.



swer. Almost all respondents answered those questions. Six questions required quantitative responses. One or more of those questions were not answered by nearly a fifth of the respondents, possibly because detailed information may not have been readily available.

The final question simply asked for any additional comments. Twelve percent of the respondents commented on some aspect of banking services.

### Survey findings

Treasurers of most of the business corporations reported District banks were better able to provide credit needs and other banking needs in 1978 than five years earlier. The relatively small number that reported no improvement or a decline in banking service levels were generally with firms of less than average size. This may indicate the major change in banking in the Southwest from 1973 to 1978 has been an improved capability to serve the banking

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**Even though most survey respondents were of the opinion that District banks were better able to provide credit and other banking needs than five years earlier, many firms reduced their share of total borrowings at District banks.**

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needs of large firms. Nevertheless, many large firms domiciled in the Eleventh District obtain large proportions of their bank loans from banks outside the District and place large proportions of their deposits with them. While treasurers of many of the smaller firms surveyed also reported the quality of banking services had improved, a number reported they detected no change. The few that reported quality had declined had reduced their borrowing from District banks from five years earlier.

A number of banking services were cited by respondents as not being provided by District banks or not being provided adequately. Firms whose markets have expanded worldwide indicated unfilled needs for international banking services. And a small number reported larger loan limits would enable banks to better serve their credit needs.

The survey confirmed that large companies tend to rely less on local banks for borrowings than small companies. District banks supplied most of the credit needs of corporate customers with annual sales of \$74 million or less, but as firm size increased, the share of total borrowings provided by southwestern banks dropped rapidly. More important, the survey indicated the proportion of total borrowings obtained at District banks by all firms declined somewhat from five years earlier. For example, the average share of total borrowing from District banks slipped from 56 percent to 48 percent. Hence, even though most respondents were of the opinion that District banks were better able to provide credit and other banking needs than five years earlier, many firms reduced their share of total borrowings at District banks.

The major reason southwestern corporations—especially large firms—obtain banking services outside the Southwest is business expansions beyond the District boundaries in recent years. But many firms also looked to banks elsewhere because they were offered better terms, District banks were too small, or District banks lacked expertise in one or more areas of service.

The business firms borrowed for a number of purposes, and the most frequent purpose was to finance inventories. Borrowing to finance accounts receivable was second. The most frequently reported purpose for borrowing from nonbank institutions was to finance real estate.

Insurance companies were the most frequently used source of nonbank borrowing, especially by firms with more than \$27 million in sales. Public debt issues were the second most frequently used source of nonbank funds. A few small firms looked to finance companies, savings and loan associations, and suppliers as their major sources of nonbank credit.

District banks are used more for deposit services than loan services by southwestern business firms. Nearly two-thirds of the respondents reported they placed 75 percent or more of their total deposits in District banks. However, large firms placed smaller proportions of deposits in southwestern banks than small firm.

District banks appear to be in a position to provide more credit and other banking services to southwestern businesses. Their corporate customers see the quality of banking services as rising and apparently would be willing to do more business with southwestern banks. Moreover, District



banks appear to have the resources to provide more credit, as the average loan-to-deposit ratio of all commercial banks in the Southwest last year was 64 percent. That was considerably below the 71-percent ratio for all commercial banks in the nation, although it was up somewhat from 61 percent five years earlier.

The rate of economic growth in the Southwest, however, may have been outpacing the growth in the ability of banks to provide business credit. Rapid-growth areas typically are capital-deficit areas. Southwestern banks, therefore, may have an opportunity to develop more effective means both to marshal local sources of funds and to tap sources of funds outside the District.

### Survey questions and responses

#### 1. Compared to five years ago, the ability of Eleventh District banks to provide all your bank credit needs (check one) has increased, is unchanged, has decreased?

	Number	Percent
Has increased ...	176	71
Is unchanged ....	54	22
Has decreased ...	12	5
No response .....	5	2

A large proportion of corporate treasurers were of the opinion District banks were better able to provide credit services in 1978 than five years before. Furthermore, those that reported an improvement in the ability of District banks to provide all bank credit needs were generally firms with annual sales over \$27 million and ranked in the upper three-quarters of the sample.

Respondents that reported the ability of District banks to provide all bank credit needs had not changed were mostly firms in the lowest quarter of the sample. And they were mostly nondurable goods and durable goods manufacturers.

Those few respondents that indicated a decrease in the ability of District banks to provide all bank credit needs had reduced their shares of borrowing from southwestern banks from five years earlier. They were firms ranked mainly in the lower half of the sample, although the largest had sales of about \$250 million. Most were in trade and nondurable goods manufacturing.

Since the survey did not ask for size of bank used by respondents, it was not possible to relate size of firm to size of bank. Similarly, no effort was made to relate creditworthiness of respondents to

their views on changes in the ability of banks to provide all their credit needs.

#### 2. Compared to five years ago, the ability of Eleventh District banks to meet your other banking needs (check one) has increased, is unchanged, has decreased?

	Number	Percent
Has increased ...	186	75
Is unchanged ....	51	21
Has decreased ...	5	2
No response .....	5	2

Most respondents indicated the ability of banks to meet corporate banking needs other than credit had increased from five years earlier. Generally, firms that reported improvement in banks' ability to provide the credit needs of businesses also reported banks had improved their ability to meet other banking needs. Improvement was reported by most firms with sales over \$27 million. Almost a third of the 51 respondents that indicated the ability of District banks to meet other banking needs was unchanged were firms in the lowest quarter of the sample, with sales below \$27 million. Four of the five respondents that reported a decrease in the ability of District banks to provide other banking needs were firms with sales of \$58 million to \$84 million, and one was a firm with sales of \$250 million.

Nearly all firms that reported no change in ability of District banks to meet other banking needs of corporate customers were oil and gas firms, durable and nondurable goods manufacturers, or wholesalers and retailers. Firms that reported improvement in the ability of the banks to meet other banking needs were distributed proportionately among all types of businesses.

#### 3. Do you have need for banking services that Eleventh District banks are unable to provide? \_\_\_\_\_ Yes \_\_\_\_\_ No If yes, what are they? What reasons do banks give for their inability to meet your needs?

	Number	Percent
Yes .....	147	60
No .....	93	38
No response ...	7	2

More than half the respondents indicated a need for banking services that District banks were unable to provide. However, only 43 percent of these cited which banking service was not provided, and even fewer reported the reasons banks had given for their inability to meet corporate needs. Among the services reported as not available, international



banking was listed more often than any other. Not surprisingly, the need for additional international banking services was reported largely by oil and gas companies and suppliers of equipment and services to the oil and gas industry. The markets served by many of these firms have expanded worldwide since the 1973 Arab oil embargo.

Banking service	Re-sponses	Per-cent
International banking .....	31	48.4
Larger loan limits .....	11	17.2
Interstate branching .....	5	7.8
Statewide branching .....	4	6.3
Better cash management .....	4	6.3
Lockboxes at more than one location .....	3	4.7
Stock transfer and registration functions ...	2	3.1
Aggressive leasing policies .....	2	3.1
Expanded real estate lending .....	2	3.1

The 11 respondents that cited a need for larger loan limits were Texas companies, and 8 were firms with sales over \$140 million. The two smallest had sales of nearly \$40 million. Five of the firms were in oil and gas; the others comprised a variety of other businesses.

Banks are limited in the amount of credit they can extend to individual customers. With some exceptions, the limit for national banks is 10 percent of the bank's capital and surplus, and for state banks in Texas the limit is 25 percent. The credit needs of some large firms exceed the lending limits of even the largest banks in the Southwest. And the credit needs of even relatively small firms may exceed the loan limit of small- or medium-size banks. In order to serve the credit needs of these firms, banks must have an effective means to collaborate.

These 11 firms obtained most of their bank credit from banks outside the District. On average, only 14 percent of their total borrowings were obtained from banks in the District. Correspondent banking and multibank holding companies possibly have opportunities for further development and refinement in the Southwest in order to provide more fully the banking services used by firms domiciled in the region.

Interstate branching was noted by five respondents as a deficient banking service. Those respondents were mainly manufacturers that need banking services in areas outside the Southwest. They indicated that they would be able to use more of the services provided by their principal bank if District banks were able to establish branches out-

side the Southwest. Generally, however, branch banking across state boundaries is prohibited by both state and Federal laws or regulations.

Most of the reasons given by banks, according to respondents, for their inability to meet corporate needs pertained to international banking services or size of bank. Seventeen respondents indicated their banks cited a lack of foreign branches or did not offer the international services that were needed. Eleven respondents reported banks cited their size as the reason why some services were not provided. Other reasons given, according to smaller numbers of respondents, were regulatory restrictions, lack of expertise in one or more service areas, and location of the bank. A few respondents replied they had not inquired as to why some bank services were not provided.

#### 4. What proportion (estimated percent) of your company's total borrowing is from (a) Eleventh District banks, (b) other banks, (c) sources other than banks—now and five years ago?

Share of borrowing	Percent of total responses		
	District banks	Other banks	Non-banks
<b>Fall 1978</b>			
100% .....	29.1	1.9	8.9
75% to 99% .....	7.7	9.4	10.7
50% to 74% .....	11.8	11.3	11.7
25% to 49% .....	11.4	9.9	8.9
1% to 24% .....	26.8	11.3	11.2
None .....	13.2	56.3	48.6
Total responses (Number) ...	220	213	214
No response (Number) .....	27	34	33
<b>Five years before<sup>1</sup></b>			
100% .....	37.8	3.5	5.6
75% to 99% .....	7.5	8.1	7.1
50% to 74% .....	11.4	10.1	11.7
25% to 49% .....	10.4	12.1	5.8
1% to 24% .....	21.4	9.1	7.7
None .....	11.4	57.1	62.2
Total responses (Number) ...	201	198	196
No response (Number) .....	31	34	36

1. Fifteen respondents indicated they were not located or headquartered in the Eleventh District at that time.

This question was answered in whole or in part by 89 percent of all respondents. The quantitative responses appeared to contradict the consensus that the ability of District banks to provide all bank credit needs had increased. While a large group of



businesses did all their borrowing at District banks, the proportion of such firms declined from 38 percent five years earlier to 29 percent last fall.

Less than half the firms (44 percent) reported that a portion of their borrowed funds came from banks outside the District, and this portion was about the same as five years earlier. More than half the firms borrowed from nonbank sources, but less than a tenth reported this was the source of all their borrowings. Both the proportion of firms that borrowed from nonbank sources and the proportion that borrowed exclusively from these sources had increased from five years earlier.

Averaging firm sales in each size category and the proportion of borrowings obtained at District banks indicated larger companies tended to rely less on southwestern banks while smaller companies tended to rely on them for greater shares of total borrowings. For example, the largest firms had average sales of \$1 billion and obtained 24 percent of their total borrowings at District banks (Appendix Table 1).<sup>2</sup> The smallest firms had average sales of \$10 million and received two-thirds of their borrowed funds from District banks.

A cross tabulation of respondents by size and proportion of borrowings obtained at District banks also reflected the heavier reliance of smaller firms on local banks (Appendix Table 2). For example, the respondents that reported all borrowed funds came from District banks were mainly firms with sales below \$74 million. For larger firms the share of total borrowings provided by District banks dropped rapidly and was mostly in the 1 percent-24 percent borrowing category. For the largest corporations, District banks accounted for only a small share of total borrowings, with large

amounts obtained from nonbank sources and banks outside the District.

An examination of the share of borrowing by the largest respondents, with sales over \$200 million, revealed how little many of those corporations used District banks for credit. Of the 54 respondents in that size category that answered the question, 10 did not borrow from southwestern banks and 16 obtained 10 percent or less of their total borrowings from District banks. Only four firms—three manufacturers and a retailer—received all their borrowed funds from District banks. No other respondents, except a natural gas distribution company, obtained more than half their borrowings from District banks.

The largest firms obtained most of their credit from nonbank sources: 18 respondents obtained three-quarters or more of their loans from nonbank sources, and 8 used banks outside the Southwest for three-quarters or more of their total borrowings. More than half of these 26 firms were in two industry categories—transportation, communications, and gas services or durable goods manufacturing.

A cross tabulation by share of total borrowing at District banks and principal line of business revealed that the firms obtaining all their borrowings at southwestern banks tended to be in construction, services, and real estate (Appendix Table 3). A relatively small proportion of firms in transportation, communications, and gas services or oil and gas extraction borrowed entirely from District banks; the biggest proportion of these respondents obtained 1 to 24 percent of their total borrowings at District banks. A large proportion of real estate firms also obtained a relatively small share of total borrowings at southwestern banks.

Compared with five years earlier, the proportion of firms that borrowed entirely from District banks declined in most business categories. The biggest declines were in oil and gas extraction, services, and nondurable goods manufacturing, while the proportion in construction was unchanged.

##### **5. List, in order of importance, sources of borrowing other than banks used by your company.**

Most respondents to this question listed only one source of borrowing other than banks. More than a third, however, used two sources, and over a tenth had three or four sources.

Insurance companies were the most frequent source of borrowing other than commercial banks. More than half the respondents listed them as the

2. Because the average share of borrowing had declined in each firm-size category from five years earlier, statistical tests were performed by pooling the data to determine if the differences between the average shares of borrowing from 1973 to 1978 within each category were significant. The results indicated that there was a statistical difference at the 90-percent confidence level for firms in the \$27 million-\$74 million size category. A likely reason that the tests revealed no statistical differences for the other size categories was the large variance of the responses in those groups. If the respondents in those size categories had been classified further (by such criteria as principal line of business, location of firm, or size of bank used by the firm) to reduce the variation in responses, significant differences would likely have been detected—indicating many respondents did reduce their share of total borrowing at District banks from five years earlier.



most important source of nonbank funds, and most were firms with \$27 million or more in sales. In fact, only 5 percent of the respondents that had sales below \$27 million reported borrowing from insurance companies, while the other responses were fairly evenly distributed over the medium- and large-size firms. And a third or more of all respondents in every business category, with the exception of agriculture and construction, reported insurance companies as an important source of nonbank credit.

Nonbank source of funds	Number of listings				Percent of question respondents
	Order of importance				
	1st	2nd	3rd	4th	
Insurance companies	71	16	1	—	56.1
Public debt issues ..	22	15	2	—	24.8
Commercial paper ..	11	2	—	—	8.3
Finance companies .	9	—	2	1	7.6
Private placements .	9	2	—	—	7.0
Leasing companies .	7	6	4	—	10.8
Savings and loan associations .....	6	3	—	—	5.7
Mortgage companies	4	2	—	1	4.5
Government agencies .....	3	—	—	—	1.9
Equity financing ...	2	4	2	—	5.1
Suppliers .....	2	1	1	—	2.5
Foreign sources ....	—	2	1	1	2.5
Bankers acceptances	—	1	—	—	.6

Public debt issues were second in overall importance as a nonbank source of funds and were reported to be used by nearly a quarter of all respondents to the question. Public debt issues were used mainly by firms with sales over \$27 million. Moreover, nearly a fifth of the respondents in oil and gas extraction, durable goods manufacturing, and transportation, communications, and gas services reported public debt issues as an important source of nonbank credit. Other industry categories used this source of financing much less.

For small firms responding to the question, finance companies, savings and loan associations, and suppliers were reported to be sources of nonbank credit.

**6. For what purposes does your company borrow and from what sources (check all that apply)—Eleventh District banks, other banks, nonbank institutions?**

The purpose most frequently reported for borrowing was to finance inventories, according to 84 percent of the respondents to the question. That

topped all other purposes at both District banks and other banks. Borrowing to finance accounts receivable ranked second at District banks. The most frequent purpose for borrowing from nonbank institutions was to finance real estate.

Purpose of loans	Number of responses		
	District banks	Other banks	Non-banks
Inventories .....	88	41	25
Accounts receivable ....	63	21	21
Real estate .....	42	24	58
Working capital .....	38	15	10
Capital expenditures ....	28	20	24
Taxes .....	26	17	7
Payroll .....	20	12	5
Equipment .....	19	8	16
Acquisitions .....	12	4	7
Construction .....	4	4	4
Oil and gas properties ...	3	3	1

Cross tabulation by purpose of loan, source of loan, and size of firm did not substantially change the order of importance of purposes for which firms borrowed at District banks (Appendix Table 4). The percentage distribution of borrowing by size of firm was fairly consistent between District banks and banks outside the Southwest. The distribution of borrowing at nonbank institutions reflected a higher incidence of real estate financing.

**7. Reasons for obtaining banking services outside the Eleventh District (indicate in order of importance all that apply)—Eleventh District banks too small; Eleventh District banks lack expertise (specify service areas); obtained where business is conducted; better terms; other (specify)?**

One or more reasons for obtaining banking services outside the District were given by two-thirds of the respondents to the question. Many respondents, however, did not indicate the order of importance but only checked why borrowings were made outside the District. Therefore, the responses were only tabulated by the reason for out-of-District banking.

The main reason southwestern corporations obtained banking services outside the District was the location of their business activity, rather than their headquarters. Many indicated they have always conducted a substantial amount of business outside the District. But the geographic markets of such industries as oil and gas and trade have expanded widely in recent years. Other reasons of



major importance were better terms, District banks were too small, and District banks lacked expertise in one or more areas of service.

Not surprisingly, respondents with sales greater than \$74 million gave more reasons for obtaining banking services outside the Southwest than smaller firms. The frequency of response for such reasons as location of business, better terms, and District banks too small varied directly with firm size. The distribution of responses that District banks lacked expertise, however, was fairly uniform with respect to firm size.

Reason	Re-sponses	Percent of question respondents
Location of business	74	45.7
Better terms	48	29.6
District banks too small	47	29.0
District banks lack an area of expertise	41	25.3
Established credit lines outside Southwest	13	8.0
Maintain geographic diversification of banking relationships	12	7.4
International banking services	6	3.7
Improved cash management	1	.6
Availability of lockboxes	1	.6
Stock transfer and registration services	1	.6

Three-quarters of the responses from real estate firms indicated they banked outside the Southwest because that is where part of their business is located. More than two-fifths of the respondents in construction and nondurable goods manufacturing also gave that as a reason. Better terms were also reported by nearly two-fifths of the real estate firms, followed by nearly three-tenths of the respondents in construction and nondurable goods manufacturing. In addition, 43 percent of the construction firms and nearly 30 percent of the oil and gas companies had banking ties outside the Southwest because they were of the opinion District banks were too small. Almost two-fifths of the respondents in real estate and a fifth of the oil and gas firms also indicated District banks lacked expertise in one or more service areas.

Twenty-four respondents specified service areas in which, in their opinion, Eleventh District banks lacked expertise. International banking was cited 21 times, while long-term financing, trust management, and a knowledge of coal mining were each noted once.

### 8. What proportion (estimated percent) of total deposits does your company place with (a) Eleventh District banks, (b) other banks, (c) nonbank financial institutions—now and five years ago?

Share of deposits	Percent of total responses		
	District banks	Other banks	Non-banks
<b>Fall 1978</b>			
100% . . . . .	34.7	0.5	0.0
75% to 99% . . . . .	31.4	18.3	.4
50% to 74% . . . . .	8.9	9.1	.0
25% to 49% . . . . .	10.6	10.0	.0
1% to 24% . . . . .	14.0	24.2	3.0
None . . . . .	.4	37.9	96.5
Total responses (Number) . . .	236	219	230
No response (Number) . . . . .	11	28	17
<b>Five years before<sup>1</sup></b>			
100% . . . . .	39.3	1.6	.0
75% to 99% . . . . .	26.7	14.8	.0
50% to 74% . . . . .	13.1	10.1	.0
25% to 49% . . . . .	7.7	10.6	.0
1% to 24% . . . . .	11.7	19.0	2.1
None . . . . .	1.5	43.9	97.9
Total responses (Number) . . .	206	189	189
No response (Number) . . . . .	26	43	43

1. Fifteen respondents indicated they were not located or headquartered in the Eleventh District at that time.

District banks accounted for larger proportions of deposits than borrowings of the business firms. Slightly more than a third of the respondents to the question reported they used District banks exclusively for deposits, and about two-thirds reported they place 75 percent or more of their total deposits in District banks. Large firms used out-of-District banks for deposit services much more than did small firms. For example, firms in the largest size category placed 51 percent of their deposits in District banks, while the smallest firms deposited 90 percent of their funds in southwestern banks (Appendix Table 1).

A tabulation by size of firm and share of deposits placed in District banks showed that most firms with less than \$74 million in sales deposited three-quarters or more of their funds in southwestern banks (Appendix Table 5). Larger firms, on the other hand, frequently placed smaller proportions of deposits in District banks. However, there were differences among larger firms. About a third of the firms with sales of \$200 million or more placed 75 to 99 percent of their deposits in District banks.



Another third of the largest firms placed only 1 to 24 percent of deposits in District banks.

Cross tabulation of the responses by principal line of business showed a high percentage placement of total deposits in District banks for most industries (Appendix Table 6). Nearly 35 percent of all respondents placed all their deposits in District banks, and an additional 31 percent placed 75 to 99 percent of their deposits in District banks. In both categories the only industries in which three-fifths of the firms did not place 75 percent or more of their deposits in District banks were agriculture, oil and gas extraction, and transportation, communications, and gas services.

A comparison of the percentage distribution of deposit shares last fall with the patterns that ex-

isted five years earlier showed few significant changes on the basis of either size of firm or principal line of business. It was evident, however, that fewer respondents placed all their deposits in District banks.

#### 9. How long has your firm been headquartered in the Southwest? \_\_\_\_\_ years

Only 15 respondents indicated their firms had been headquartered or located in the Southwest less than five years. The survey results, therefore, were not affected significantly by firms recently organized or recently moved to the Southwest.

## Appendix

**Table 1**

**AVERAGE SALES OF SOUTHWESTERN CORPORATIONS, SHARE OF TOTAL BORROWING AT ELEVENTH DISTRICT BANKS, AND SHARE OF TOTAL DEPOSITS PLACED IN THOSE BANKS, BY RANK OF FIRMS' SALES**

(Unweighted averages of individual-firm data)

Firm-size category (Rank of annual dollar sales)	Average sales, 1977 (Millions of dollars)	Average share of total borrowing (Percent)		Average share of total deposits (Percent)	
		Fall 1978	Five years before	Fall 1978	Five years before
1 to 85 . . . . .	\$1,000	24	29	51	54
66 to 125 . . . .	122	43	50	67	70
126 to 191 . . . .	50	59	68	83	83
192 to 247 . . . .	10	67	75	90	89



**Table 2**

**DISTRIBUTION OF TOTAL BORROWING BY SOUTHWESTERN CORPORATIONS AT ELEVENTH DISTRICT BANKS, BY RANK OF FIRMS' SALES**

Firm-size category (Rank of annual dollar sales)	Percent of total responses						Number	
	Share of total borrowing at Eleventh District banks							
	100%	75% to 99%	50% to 74%	25% to 49%	1% to 24%	None	Total re- sponses	No re- sponse
<b>Fall 1978</b>								
1 to 65 .....	7.4	5.6	3.7	20.4	44.4	18.5	54	11
66 to 125 .....	20.8	9.4	11.3	15.1	32.1	11.3	53	7
126 to 191 .....	39.3	6.6	19.7	3.3	18.0	13.1	61	5
192 to 247 .....	48.1	9.6	11.5	7.7	13.5	9.6	52	4
<b>Five years before<sup>1</sup></b>								
1 to 65 .....	10.9	6.5	8.7	4.3	56.5	13.0	46	11
66 to 125 .....	29.4	5.9	13.7	17.6	21.6	11.8	51	7
126 to 191 .....	48.2	8.9	16.1	7.1	5.4	14.3	56	6
192 to 247 .....	60.4	8.3	6.3	12.5	6.3	6.3	48	7

1. Fifteen respondents indicated they were not located or headquartered in the Eleventh District at that time.

**Table 3**

**DISTRIBUTION OF SHARE OF TOTAL BORROWING BY SOUTHWESTERN CORPORATIONS AT ELEVENTH DISTRICT BANKS, BY PRINCIPAL LINE OF BUSINESS**

Principal line of business	Percent of total industry response						Number of industry responses
	Share of total borrowing at Eleventh District banks						
	100%	75% to 99%	50% to 74%	25% to 49%	1% to 24%	None	
<b>Fall 1978</b>							
Agriculture .....	0.0	0.0	0.0	0.0	33.3	66.7	3
Oil and gas extraction .....	25.0	8.3	10.4	14.6	31.3	10.4	48
Construction .....	57.1	.0	.0	28.6	14.3	.0	7
Manufacturing							
Nondurable goods .....	30.0	.0	13.3	10.0	30.0	16.7	30
Durable goods .....	31.7	10.0	13.3	10.0	18.3	16.7	60
Transportation, communications, and gas services .....	14.3	14.3	9.5	4.8	42.9	14.3	21
Trade .....	29.4	8.8	17.6	17.6	14.7	11.8	34
Real estate .....	37.5	.0	.0	.0	62.5	.0	8
Services .....	40.0	10.0	10.0	.0	30.0	10.0	10
Total .....	29.0	7.7	11.8	11.3	26.7	13.6	221
<b>Five years before<sup>1</sup></b>							
Agriculture .....	.0	.0	.0	.0	33.3	66.7	3
Oil and gas extraction .....	42.2	.0	15.6	13.3	20.0	8.9	45
Construction .....	57.1	.0	.0	.0	42.9	.0	7
Manufacturing							
Nondurable goods .....	39.3	7.1	7.1	10.7	28.6	7.1	28
Durable goods .....	37.7	9.4	15.1	7.5	17.0	13.2	53
Transportation, communications, and gas services .....	22.2	11.1	11.1	11.1	27.8	16.7	18
Trade .....	36.4	18.2	6.1	12.1	15.2	12.1	33
Real estate .....	33.3	.0	16.7	16.7	33.3	.0	6
Services .....	50.0	.0	12.5	12.5	12.5	12.5	8
Total .....	37.8	7.5	11.4	10.4	21.4	11.4	201

1. Fifteen respondents indicated they were not located or headquartered in the Eleventh District at that time.



**Table 4**

**PURPOSES FOR WHICH SOUTHWESTERN CORPORATIONS BORROW, BY SOURCES OF LOANS AND RANK OF FIRMS' SALES**

Source and purpose of loans	Percent of total responses			
	Firm-size categories (Rank of annual dollar sales)			
	1 to 65	66 to 125	126 to 191	192 to 247
<b>Eleventh District banks</b>				
Inventories .....	26.7	22.3	29.3	23.7
Accounts receivable .....	20.0	11.8	23.2	17.1
Real estate .....	8.9	14.5	9.1	15.6
Working capital .....	8.9	13.2	11.1	11.8
Capital expenditures .....	12.2	9.2	6.1	5.3
Taxes .....	7.8	9.2	8.1	5.3
Payroll .....	6.7	6.6	5.1	5.3
Equipment .....	1.1	6.6	5.1	10.5
Acquisitions .....	3.3	5.3	3.0	2.6
Construction .....	4.4	.0	.0	.0
Oil and gas properties .....	.0	1.3	.0	2.6
Total responses (Number)...	90	76	99	76
<b>Other banks</b>				
Inventories .....	23.1	20.9	29.4	23.1
Accounts receivable .....	20.7	14.0	17.6	15.4
Real estate .....	14.6	14.0	11.8	15.4
Working capital .....	8.5	4.7	5.9	15.4
Capital expenditures .....	7.3	18.6	8.8	15.4
Taxes .....	8.5	11.6	14.7	.0
Payroll .....	7.3	7.0	5.9	7.7
Equipment .....	2.4	7.0	2.9	7.7
Acquisitions .....	2.4	2.3	2.9	.0
Construction .....	4.9	.0	.0	.0
Oil and gas properties .....	.0	.0	.0	.0
Total responses (Number)...	82	43	34	13
<b>Nonbank institutions</b>				
Inventories .....	15.2	13.3	14.6	8.0
Accounts receivable .....	10.6	11.1	12.5	12.0
Real estate .....	27.3	35.6	35.4	28.0
Working capital .....	6.1	8.9	6.3	8.0
Capital expenditures .....	12.1	20.0	12.5	4.0
Taxes .....	6.1	2.2	4.2	.0
Payroll .....	6.1	.0	2.1	.0
Equipment .....	6.1	4.4	6.3	28.0
Acquisitions .....	4.5	4.4	6.3	4.0
Construction .....	6.1	.0	.0	.0
Oil and gas properties .....	.0	.0	.0	8.0
Total responses (Number)...	66	45	48	25



Table 5

**DISTRIBUTION OF TOTAL DEPOSITS PLACED IN ELEVENTH DISTRICT BANKS  
BY SOUTHWESTERN CORPORATIONS, BY RANK OF FIRMS' SALES**

Firm-size category (Rank of annual dollar sales)	Percent of total responses						Number	
	Share of total deposits in Eleventh District banks							
	100%	75% to 99%	50% to 74%	25% to 49%	1% to 24%	None	Total re- sponses	No re- sponse
<b>Fall 1978</b>								
1 to 65 .....	10.0	31.7	6.7	16.7	35.0	0.0	60	5
66 to 125 .....	19.0	36.2	15.5	17.2	10.3	1.7	58	2
126 to 191 .....	43.5	38.7	6.5	3.2	8.1	.0	62	4
192 to 247 .....	67.9	17.9	7.1	5.4	1.8	.0	56	0
<b>Five years before<sup>1</sup></b>								
1 to 65 .....	16.0	28.0	8.0	14.0	34.0	.0	50	7
66 to 125 .....	24.1	31.5	22.2	13.0	9.3	.0	54	4
126 to 191 .....	50.9	24.5	15.1	1.9	1.9	5.7	53	9
192 to 247 .....	67.3	22.4	6.1	2.0	2.0	.0	49	6

1. Fifteen respondents indicated they were not located or headquartered in the Eleventh District at that time.

Table 6

**DISTRIBUTION OF SHARE OF TOTAL DEPOSITS PLACED IN ELEVENTH DISTRICT BANKS  
BY SOUTHWESTERN CORPORATIONS, BY PRINCIPAL LINE OF BUSINESS**

Principal line of business	Percent of total industry response						Number of industry responses
	Share of total deposits in Eleventh District banks						
	100%	75% to 99%	50% to 74%	25% to 49%	1% to 24%	None	
<b>Fall 1978</b>							
Agriculture .....	50.0	0.0	0.0	0.0	50.0	0.0	2
Oil and gas extraction .....	30.0	26.0	16.0	14.0	14.0	.0	50
Construction .....	40.0	30.0	.0	10.0	20.0	.0	10
Manufacturing							
Nondurable goods .....	37.1	34.3	5.7	11.4	8.6	2.9	35
Durable goods .....	36.5	31.7	9.5	11.1	11.1	.0	63
Transportation, communications, and gas services .....	20.0	35.0	5.0	.0	40.0	.0	20
Trade .....	34.3	42.9	8.6	5.7	8.6	.0	35
Real estate .....	60.0	10.0	.0	10.0	20.0	.0	10
Services .....	36.4	27.3	9.1	27.3	.0	.0	11
Total .....	34.7	31.4	8.9	10.6	14.0	.4	236
<b>Five years before<sup>1</sup></b>							
Agriculture .....	.0	50.0	.0	.0	50.0	.0	2
Oil and gas extraction .....	40.5	21.4	16.7	7.1	9.5	4.8	42
Construction .....	40.0	10.0	20.0	10.0	20.0	.0	10
Manufacturing							
Nondurable goods .....	34.5	31.0	10.3	10.3	13.8	.0	29
Durable goods .....	39.3	23.2	17.9	8.9	10.7	.0	56
Transportation, communications, and gas services .....	29.4	35.3	5.9	5.9	17.6	5.9	17
Trade .....	47.1	32.4	8.8	5.9	5.9	.0	34
Real estate .....	50.0	25.0	.0	.0	25.0	.0	8
Services .....	37.5	37.5	12.5	12.5	.0	.0	8
Total .....	39.3	26.7	13.1	7.8	11.7	1.5	206

1. Fifteen respondents indicated they were not located or headquartered in the Eleventh District at that time.





# Regulatory Briefs

Review of Recent Actions of the Board of Governors of the Federal Reserve System

• **REGULATIONS PROHIBITING INTERLOCKING MANAGEMENT RELATIONSHIPS** between certain nonaffiliated depository institutions have been published for public comment by the five Federal financial institution regulators. The proposed regulations carry out the new Depository Institution Management Interlocks Act, which became effective March 10, 1979. Under the regulations, four types of management interlocks, where competition is not present and where public benefits would outweigh competitive factors, are exempted from the general prohibition. One exemption is for institutions located in low-income areas or managed by members of minority groups or by women. This exemption would permit limited interlocks for up to five years. The second exemption, which could last up to two years, would be for newly chartered institutions. The other two exemptions are for depository institutions in deteriorating condition and for credit unions sponsored by depository institutions solely for their own employees.

• **THE MOST COMMON QUESTIONS ABOUT THE COMMUNITY REINVESTMENT ACT** have been answered in a joint statement by the four Federal agencies responsible for enforcement of the act. Copies of the questions and answers are available from the Bank and Public Information Department of this Bank, (214) 651-6267. Any additional questions about the act or its implementing Federal Reserve Regulation BB may be directed to the Consumer Affairs Division, (214) 651-6171.

• **A NEW INTERPRETATION REGARDING THE PAYMENT OF INTEREST ON A TIME CERTIFICATE OF DEPOSIT** has been issued by the Board of Governors. Under the interpretation, a member bank may permit a depositor to withdraw interest earned on a time certificate at any time before maturity without penalty, regardless of how the bank compounds or credits interest. Previously, interest that had accrued on a time deposit and was posted to the account was subject to the Regulation Q early-withdrawal penalty. Questions should be directed to the Consumer Affairs Division of this Bank, (214) 651-6171.



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**New nonmember bank**

First City Bank-Bear Creek, Houston, Texas, a newly organized insured non-member bank located in the territory served by the Houston Branch of the Federal Reserve Bank of Dallas, opened for business March 1, 1979.

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