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Best Seat in the House? Credit Unions' Place in the Financial Services Industry

Credit Unions' Place in the Financial Services Industry

Making loans, offering savings accounts, providing checking accounts—isn't this what credit unions—er, banks—do? As a matter of fact, yes. Credit unions play a smaller role in the U.S. financial system than do banks, but—much to the chagrin of bankers—their role has grown over time.

Credit Unions' Niche

Credit unions are regulated and insured financial institutions dedicated to helping targeted groups of consumers meet their savings, credit and other basic financial needs. By law, credit unions are cooperative enterprises controlled by their members. In addition, credit union members must be united by a "common bond of occupation or association, or [belong] to groups within a well-defined neighborhood, community or rural district," according to the Federal Credit Union Act (FCUA) of 1934. In 1998, the Supreme Court issued a statement that said, "Credit unions were believed to enable the general public, which had been largely ignored by banks, to obtain credit at reasonable rates.

Historically, members of credit unions were drawn from groups that were underserved by traditional private financial institutions; these consumers tended to have below-average incomes or were otherwise not sought out by banks. Today, however, the demographic characteristics of credit union members have become more like those of the median American. In fact, current members are over-represented by the upper-middle income strata, defined as household incomes between $30,000 and $80,000 in 1987.

Only 1 percent of the U.S. adult population aged 18 or over belonged to a credit union in 1935, but about 38 percent of the adult population had joined by 2001. Not surprisingly, given the prominent role of occupational credit unions, a majority of members of all credit unions are in the prime working age group of 25-44. According to a 1987 credit union survey, 79 percent of all Americans who were eligible to join a credit union had done so. It appears that credit unions, banks and thrifts (savings and loans associations) are more direct competitors today than when credit unions first appeared.

Bankers Feel the Squeeze

The American Bankers Association (ABA) has alleged that the playing field is not level. Their arguments are based on three premises. First, bankers believe it is unfair that credit unions are exempt from federal taxation while the taxes that banks pay represent a significant fraction of their earnings—33 percent last year. Credit union advocates say this is justified because they cannot raise equity in a public offering (i.e., a stock offering); so, they must be able to build capital internally

Second, bankers believe that credit unions have been allowed to expand far beyond their original purpose. Originally, credit unions were to be organized around a field or fields of membership such as occupation (the employees of a firm), association (such as a religious or fraternal organization) or geographic location (all individuals who live, work, attend school or worship within a defined community). In 1998, however, President Bill Clinton signed the Credit Union Membership Access Act, which, among other provisions, allows credit unions to accept additional membership groups with multiple common bonds so long as the group to be acquired has fewer than 3,000 members.

Third, banks are concerned about how credit unions are regulated and the financial services they're allowed to offer. For example, banks are subject to the Community Reinvestment Act (CRA), which requires them to make specified amounts of loans in the communities in which they take deposits. Credit unions are exempt from CRA. As for services, credit unions have been allowed to increase the amount of business lending they do. This frustrates bankers, who believe that credit unions should focus on households.

Does Size Matter?

Credit unions numbered 10,041 at the end of last year, serving more than 80 million members. At the same time, there were 7,887 FDIC-insured commercial banks and 1,534 insured thrift institutions. Most credit unions are small, though. Credit union assets totaled $575 billion, compared to $7,075 billion held by commercial banks and $1,359 billion held by thrifts. The deposits (or, technically, "shares") of virtually all credit unions are now federally insured by the National Credit Union Administration (NCUA), regardless of the type of charter the credit union holds. In terms of size, most credit unions had less than $10 million in assets in mid-2000. Large credit unions exist, however, and they are an important part of the sector. For example, the 15 percent of credit unions with more than $50 million in assets (1,554 institutions) accounted for 79 percent of total credit union assets.

Credit unions play a limited role in the U.S. financial system. More than 95 percent of all federal credit unions offer automobile and unsecured personal loans. Large credit unions also offer mortgages, credit cards, loans to purchase planes, boats or recreational vehicles, ATM access, certificates of deposit and personal checking accounts. Only about 14 percent of credit unions have business loans outstanding. Clearly, by any measure, credit unions are much smaller than banks. Nonetheless, from the perspective of some, their seat at the financial services table is an enviable one.

Questions for Classroom Discussion

1. Why were credit unions formed?
2. Bankers' allegations that credit unions have an unfair advantage are based on what three components?
3. Why does it appear that credit unions, banks and thrifts are in more direct competition today than in former times?
4. What is your view on the banks vs. credit unions debate?

This article was adapted from "Credit Unions Make Friends—But Not with Bankers," which was written by William R. Emmons and Frank A. Schmid and appeared in the October 2003 issue of The Regional Economist*, a St. Louis Fed publication.*

INSIDE THE VAULT | FALL 2003
https://www.stlouisfed.org/publications/inside-the-vault/fall-2003/q--a

Q & A

Why are many states experiencing budget deficits?

During the economic boom of the 1990s, most states enacted permanent tax cuts. Also during this period, states began relying on capital gains and income from stock options and bonuses as a growing source of tax revenue (which are relatively more volatile revenue sources compared with ordinary earned income). Slow economic growth from the 2001 recession, a weak stock market and an increase in homeland security responsibilities in the wake of the terrorist attacks of Sept. 11, 2001, contributed to budget shortfalls.

Did states raise taxes during the recent recession?

Fewer than 20 states have raised taxes since the 2001 recession, whereas in the 1990-1991 recession nearly every state raised taxes in response to budget shortfalls.

Are current budget deficits due to a reduction in revenue, or have state expenditures increased also?

The growth in real per capita expenditures during the 1990s—averaging 1.4 percent from 1992 to 2000—was not greater than that of earlier decades. Real per capita expenditures for the past three years, however, rose by 1.3 percent, 3.4 percent and 1.3 percent, respectively. During these three years, real per capita state revenue fell by 0.2 percent in 2000, 1.9 percent in 2001 and 0.7 percent in 2002.

Didn't other periods of recession cause states to experience budget deficits?

Although it's not uncommon for states to experience budget deficits during recessionary periods, state budget surpluses prior to this recent recession were smaller than those prior to earlier recessions, thus increasing the chances that a reduction in revenue would lead to a budget deficit.

The Q & A information was adapted from "State Budget Crises: Cause and Effect," which was written by Thomas A. Garrett and appeared in the November 2003 issue of National Economic Trends, *a St. Louis Fed publication.*

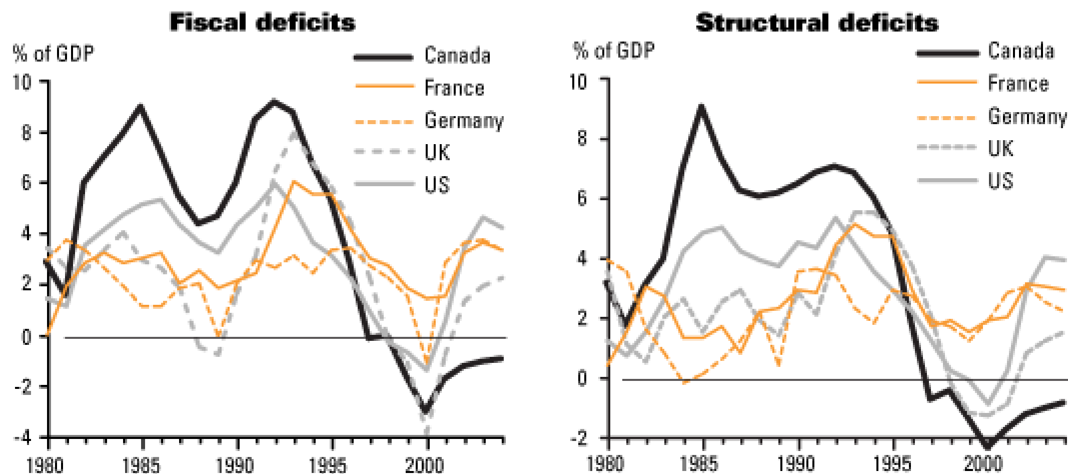
INSIDE THE VAULT | FALL 2003
https://www.stlouisfed.org/publications/inside-the-vault/fall-2003/economic-snapshot

Economic Snapshot

3rd Quarter 2003

	Q4-02	Q1-03	Q2-03	Q3-03
Growth Rate—Real Gross Domestic Product	1.4%	1.4%	3.3%	8.2%*
Inflation Rate—Consumer Price Index	2.0%	3.9%	0.6%	2.3%
Civilian Unemployment Rate	5.9%	5.8%	6.2%	6.1%

**Preliminary Estimate*



Graph from November 2003 issue of *International Economic Trends*.

What is the difference between fiscal deficits and structural deficits?

Fiscal deficits—government outlays less tax receipts—react to business cycle shocks such as technology, demographics, commodity prices and political uncertainty. The portion of a deficit that is due to the level of economic activity is called the cyclical deficit, while the structural deficit is the shortfall that would exist even if

the level of economic output were at its potential. Cyclical deficits do not threaten long-term fiscal solvency because they will be reversed over time. Large structural deficits, however, cannot be maintained forever and might require adjustments to tax and spending policies.

What causes structural deficits?

Structural deficits change with tax and spending choices that are unrelated to economic conditions. For example, the U.S. deficit rose in 1992 when savings and loan depositors were bailed out. And the terrorist attacks of Sept. 11, 2001, and wars in Afghanistan and Iraq increased the U.S. deficit through higher defense and homeland security expenditures. The U.S. deficit in 2002 (3.4 percent of GDP) was mostly structural (2.9 percent), not cyclical.

This information was adapted from "Global Factors in Budget Deficits," which was written by Christopher J.Neely and appeared in the November 2003 issue of International Economic Trends*, a St. Louis Fed publication.*