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The Impact Of Geographic Deregulation On The American Banking Industry

Economics Department within the Arts & Sciences Honors Program

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INTRODUCTION:

The banking structure as it is known today in the United States largely originated in the 1930s after the onslaught of the Great Depression. The Federal Deposit Insurance Company developed deposit insurance to stabilize the industry and protect consumers. They laid down rules and regulations that shaped the banking and financial sector of the American economy into the early form of what patrons use today. This structure formed how the public viewed the industry. Large banks were concentrated in financial centers, mostly New York, with some scattered in the west coast and other big cities. Most smaller towns had one or two state-chartered commercial banks with thrift institutions flourishing alongside. Personal and even business customers banked on a small, local scale. Sixty plus years later, the same industry structure is still in place, but its face has changed dramatically.

It's quite easy to think that banking has stayed static through the years and that like any other good old American institution it dates back to before the world wars. Banks have always taken deposits, cashed checks, offered credit, etc. But even a 20 year old college student has enough experience to have witnessed at least the most recent major change in banking. Watching the bank downtown that was at one time Shawmut, one time BankBoston, one time Fleet, proceed to branch throughout the state is knowledge enough. A dramatic shift has taken place, and most of it in the past 30 years. The financial system of the United States in the 21st century is vastly different from the one that was commonly used only one generation ago and barely recognizable from what was set in place at the dawn of the FDIC. The banking system has not been seriously altered, but the way banking is done will never be the same.

After the Great Depression the FDIC was developed in order to have a system in place to regulate banking in the United States in an effort to prevent the problems of the late 1920s and early 30s. These laws included precise rules governing bank branching and other geographical issues. This also was the birth of thrift institutions and the delegations of roles between different types of banks. Strict rules were put in place for specific reasons: such as spurring mortgage growth and preventing excessive lending. This system remained relatively stable for close to 40 years thanks to a relatively stable and growing economy. Home loans and new housing grew abundantly while at the same time deposit insurance protected customers and boosted consumer confidence in the economy.

Due to prevailing economic conditions and other factors, however, the 1970s became a time of deregulation. It was thought that the market could better allocate resources if left to its own due. With this came a sweeping drawback of the rules that had been in place for years. In this paper the laws that will be focused on specifically are the laws that affected the geography of the banking industry. The initial proposing ideas for beginning geographic deregulation and the opposing views will be discussed, along with the actual measures taken. The initial effects of the new laws and the reaction taken by the Fed in terms of new laws will also be looked at.

When the laws were altered in the 1970s to allow branching across state lines, the banking industry took its first big step towards laying the groundwork for the industry that we see today. Unfortunately, all of these new changes did not affect all members of the banking industry for the better. The increase in competition, combined with the increased allowance for risk taking caused the demise of many banks. This greatly affected thrift

institutions and directly led to what has come to be known as the savings and loan crisis. The allowance of branching across state lines and changes in charter regulations also had a major impact on all types of banks. The physical geography of the industry was shifted out of the major cities and into suburbia and small towns. This caused its own slew of bank failures and in turn, major bank consolidation.

In the years following the deregulation and in the early 1980s, the United States lost a record number of commercial banks and thrift institutions to failure. Some bigger banks used the new laws to acquire failing banks, but regardless, the number of total banks dropped dramatically. The FDIC took measures to prevent what could have been an even more drastic effect on the banking industry. A bold measure was to allow out of state banks to purchase failing banks. Banks that could afford it jumped at this opportunity and started the ball rolling on big interstate ventures. The banks that were in the shape to spend money at this time were mostly ones categorized as 'big banks' from large financial centers where they had already been used to competition. These transactions would be a foreshadowing of the next few decades in the industry.

Another unique factor in the change within the banking industry is what is known as the New England experiment. Prior to the 1970s, in an area of the country known for its close state borders and interstate transactions, laws had already been altered to allow for a certain amount of interstate banking. Thrifts in the New England states were also granted special product powers at an earlier date than the rest of the country. These states had more of a transition time and can be used as a control group to compare to the United States as a whole. The process occurred more naturally than the deregulation of the entire country. It

arose primarily from the needs and wants of customers in the New England states. New England had a longer time to adapt and an isolated environment. Three of the only five states that were able to retain their original number of banks during the 1980s were New England states, suggesting that this experiment was more of a success than the entire country.

The simultaneous changes in the lives of Americans and the American economy outside of banking can not be ignored when looking at this transformation of the banking industry. In the post-war years that the banking industry was relatively stable, so was American life. The decades following the 1970s, though, were years of technological revolution and dramatic changes in methods of communication. These two specific areas of growth are vital aspects of the banking industry. They too must have had an impact on the structure of banking. The American public as a whole was also going through some changes in the 70s. Peace and prosperity had led to urban sprawl and technology allowed people to become more national and even international. All of these differences must be looked at when isolating the effects of the new laws on the banking industry.

Finally I will take a look at the outlook for the banking industry. Is it better or worse than it was prior to deregulation? I will address the quality and quantity of banking services available today as opposed to 40 years ago. How the banking industry is viewed varies among different people. Many like the new changes and many feel that the industry has lost something. Only time will be able to tell if the changes truly make the public better off. Deregulation has had one truly positive aspect, however, and that is that it has introduced greater economic efficiency. The effects of deregulation have caused interest rates

throughout the United States to become almost exactly the same. When looking at the changes this way, from a purely economic standpoint, the economy and American citizens have benefited from the loss of a previous market failure.

EARLY HISTORY:

Banking in the United States began with the establishment of the Bank of North America in Philadelphia in 1782[1]. Up until 1836 there were only nationally chartered banks, but in 1837 state chartered banks were allowed and spread to many states. From then until 1863, all commercial banks in the US were chartered by the state in which they operated. There was no actual national currency, and banks obtained funds by issuing banknotes that were redeemable for gold.[2] The National Bank Act created a new system of national banks chartered by the federal government. This marked the start of the dual banking system in the US that still exists today. This system of national and state banks as the only financial institutions lasted until 1914 with the creation of the Federal Reserve. The Fed, as this became called, proved inadequate as a central bank to deal with the financial crisis brought on by the Great Depression. It had few of the powers it holds today, and was ill equipped to deal with anything of this magnitude. Almost half of all banks, 11,000 of 24,000, failed during the Great Depression, despite the Fed's best efforts. Bank reform in the 1930s in the wake of this was long overdue. However, owing to the magnitude of the loss and fragility of the economy, the focus of rebuilding was on stabilization and controlling risk. The government hoped that strict regulation would safeguard the faltering economy and took specific efforts aimed at economic growth.

The Federal Deposit Insurance Corporation (FDIC) was created in 1933 to insure deposits and increase liquidity within the banking system. Other important reforms at the

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[1] Zhou, 11

[2] Mishkin, 231

time were the ceilings put on interest rates for deposits (Regulation Q) and more importantly geographic restrictions on banking[1]. These government enabled, localized monopolies allowed banks more profitability and less chance of closing due to heavy competition. States imposed similar laws that prohibited branching and banking across state lines. It was also at this time that thrift institutions, mostly Savings and Loans, were given their own set of regulations to focus on specific portions of the economy. Savings Banks continued to focus on consumer savings, while Savings and Loans concentrated on mortgages and real estate.

Predictions for the economy in the years following the Great Depression were grim. When the second world war broke out in Europe in 1939, American GNP was barely above the 1929 level and unemployment was hovering around 14 percent. But once the US began fighting in the war, the economy grew at unprecedented rates. Between 1948 and 1973 the rate of growth of per capita GNP rose to 2.2% per year, compared to 1.8%, which had prevailed up to 1940[2]. This increased growth brought the US up to par with most other developed nations. It continued throughout the post-war years for decades of peaceful prosperity. By 1965 S&Ls held almost half of the entire country's home loans[3]. The housing market at the same time was also booming. The regulations set in place allowed Savings and Loans to out compete commercial banks for mortgage loans and as a result, more money was available for housing. By the end of the 60s, though, the return on these

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[1] Zhou, 12

[2] Eichler, 17

[3] Ibid., 21

real estate assets were not performing as well as in the past years, which became early encouragement for deregulation.

The late 1960s and early 1970s were a time of great change in the United States, politically and economically. The housing market began to drop off and at the same time inflation, which had been stable for decades, began to rise. The years 1973-5 were the first severe recession since the Great Depression and became synonymous with the term 'stagflation.' The high inflation and interest rates at the same time were not good for the economy, but did prevent major thrift and commercial bank losses. The Carter administration did what it could throughout the end of the 70s, but managed to tumble the US further into a recession while attempting to curb inflation. The unpopularity of the faltering economy partly manifested itself in unhappiness with the government and the beginning of deregulation was born. It became the accepted opinion to rid the economy of the government control in an attempt to free the economy from the overbearing sluggishness of a recession. Many felt that the government was holding the economy, and banks and thrifts in particular, back.

GEOGRAPHIC REGULATIONS:

At the dawn of the 20th century, the banking structure in the United States was very different than it is today. It was based on fundamental practices and laws that governed how national banks and state banks were allowed to run. First of all, banks received a charter from the US government or an individual state. The bank had the option of which to choose, but in general banks chose state charters because of their less rigorous standards. Either type of bank was allowed access to the Federal Reserve System as long as a minimum criteria was met. States received a fee for granting bank charters, as well as other financial benefits, and therefore granted banks geographic monopolies in return. With the reforms of the Great Depression, most importantly the establishment of the FDIC, banks enjoyed a safe and highly protected banking industry. Their local monopolies were able to experience high profitability, while the safeguard of new regulations gave them more lucrative products. In fact, most bank failures between 1940 and 1960 were due to bank fraud.[1] Laws governing bank actions generally kept banks in positive standing.

The first major geographic regulations came in 1863 with the National Bank Act of Congress. The branching of state banks was restricted in a hope to destroy the state chartering of banks and persuade state banks to apply for federal charters.[2] This act was a means of getting more national banks to help support the Civil War because branching would not become a serious issue for about another 75 years. Congress wanted an increase in the number of federal banks to help restore public confidence in the nation's currency.

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[1] Zhou, 12

[2] Rose, 27

More National banks would also help the government pay to fight the war, because federally chartered banks were required to buy government bonds. Unfortunately for Congress' attempt to restructure the banking system, demand deposits were just starting to become popular during the war. Checkable deposits allowed banks to make loans without issuing bank notes, their previous strategy. Thanks to this, the state bank system was able to grow well beyond the scope of the federal banking system.

Next in 1927, the McFadden-Pepper Act allowed national banks to set up branch offices in their home office cites provided that state-chartered banks possessed similar branching powers.[1] It was later interpreted to basically outlaw national bank branching, which in turn had national banks running back to the state system. Eventually the law became a step towards creating more competition between national and state chartered banks. Six years later, as a reaction to the problems of the Great Depression the Glass-Steagall (National Banking) Act was passed. It evened the score between national and state chartered banks by stating that whatever rules there were for state banks in an individual state applied to national banks as well. In turn, most states voted to prohibit all full service bank branching.

This restriction of branching may have had a worsening effect on the country-wide depression by forcing individual banks to become dependant on a single community. This fact, coupled with the crumbling of the banking system, led to a weakening of public resistance to bank branching. The power to allow this, though, still rested with the states

[1] Rose, 28

and states were still wary of this. It was the common conception at the time that big banks with many branches would lure savings away from small towns and to be invested in large cities. Governments felt that this would tighten the credit available to the small towns and fuel the growth of big cities. Because of this predominant thought in the states, bankers looked to other means. Bank holding companies – companies that held the stock of one or more banks – grew rapidly in popularity among larger banking firms due to certain tax and borrowing advantages they possessed.[1]

Throughout the 1930s and 40s, these companies grew in importance and became more of a significant force as they banded together to form large confederations. Small banks feared them and large banks feared the loss of revenue of services they sold to smaller banks. Under pressure from these two groups, the United States government passed the Bank Holding Company Act in 1956 and the Douglas Amendment to that law a year later.[2] This forced BHCs to register with the Federal Reserve and allowed interstate acquisitions only if individual states specifically allowed it. When the law was passed, however, no states allowed outside entry by holding companies and none were stepping up to offer permission. Existing BHCs were allowed to continue business, but the Douglas Amendment basically spelled the end of their expansion. They were now limited to acquisitions only within their state of origin. In 1960 the government continued with its quest to keep banks small and local with the Bank Merger Act.[3] Any federally supervised bank was forced to have approval

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[1] Rose, 34

[2] Ibid., 34

[3] Ibid., 36

of its principal federal supervisor in order to merge. This was one of the final measures taken in an effort to avoid big banks and their adverse effects on competition.

In addition to the geographic regulations put into place before and after the Great Depression, the establishment of the FDIC brought with it financial regulations that also affected the geography of the industry. First there were specific pricing rules for banks and thrift institution, most specifically what is known as Regulation Q. This placed limits on the interest banks could pay for savings deposits and the interest they could charge for loans. It also prevented the payment of interest for demand deposits. There were differences built into the regulation for differentiation between commercial banks and thrift institutions, allowing them each to be more competitive in different markets. Additional laws were put into place for bank product lines. Banks and thrifts were limited in the services they could offer and in the products they could sell. These regulations helped to allow small banks to remain competitive and kept the banking structure relatively stable throughout the war and post-war years.

CHANGES IN AMERICAN GEOGRAPHY:

The post-war decades in the United States were not only those of regulatory change, but they were also years of definitive changes in the physical geography of the country. The Depression and war years saw the country focused primarily on production and manufacturing. The non-agricultural portion of the American economy was greatly centered in cities and thus the cities were the more vital locations of the financial sector of the American economy. It was at during this time that the largest and most important banks were located in the biggest cities: San Francisco, New York, Boston, etc. The peace and prosperity of the 50s and 60s in turn saw a new focus on innovation and the service industries. The city as the manufacturing center became of less importance. This also became true of the city as a financial center.

As GIs came home from war to their prefab homes and 2.5 children came the growth of American suburbia. As the cities became less and less important and national focus shifted to families and stability, people moved out of cities into single family homes. The small town became the more dominant mentality. The affordability of automobiles and improvements in public transportation also helped make this possible with their aid in commuting. One no longer had to live directly in a city to work and do business there. Increases in the quality of long-distance transportation like trains and airplanes made travel as a natural part of doing business more acceptable. All of this helped banks move from their previous "headquarters" in the major cities into the smaller suburbs where they could still remain profitable. Large banks branched, when possible, and new, single location, "local" banks and thrifts sprouted up all over the country to cater to this newfound market.

The shifting population during the 1960s and 70s also played a role in changing the makeup of the banking industry. The US population shifted toward the South, Southwest and West Coast and away from the New England states, the North Atlantic and Midwest.[1] The banks in the northern and eastern states lost important customers and more importantly revenues. These included banks with both slightly high and rather low levels of asset holdings. They needed ways to reach their departing deposits and loans so they put pressure on the national legislature to seek opportunities to bank across state lines. These banks also went to local governments to open doors to acquisitions and intrastate branching. This shift of perspectives on the part of the banks themselves helped contribute to the idea of deregulation.

In addition to all this, many larger banks centered in cities wanted to have a national presence throughout the country. Increases in communication and interstate businesses made it attractive to banks to have locations in different parts of the country. Much of the regulation discussed in the previous section was an attempt to hinder this process if at all possible. The government wanted to prevent local bank failures that they predicted would happen if the large banks were allowed to compete with the smaller ones. The regulation that came out of the Depression served to secure the mindset of local banks being small and city banks being large. It had become the way people saw the banking industry, but was beginning to show its age. Banks were starting to see that they could increase their profits by expanding outside of their individual monopoly.

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[1] Rose, 12

Also within the geography of the United States is a unique case; that of the New England states. These six states are some of the smallest in the country and put together are actually still smaller than some of the western states. Because of the size of the states, the members of the state are used to traveling and doing business in states outside their home state on a daily basis. It is not at all uncommon for people to live and work in separate states. New England was also one of the few geographic locations within the US that experienced a net loss in population during the final quarter of the 20th century. Due to this rare nature, laws were adapted to allow interstate banking in New England before the country-wide deregulation of the 1970s. This acts as almost a control group when looking at deregulation of the country as a whole.

NEW ENGLAND EXPERIMENT:

In July 1970, a savings bank petitioned the Massachusetts Commissioner of Banks for permission to offer a savings account that could be accessed by negotiable orders of withdrawal, allowing accountholders to make check-like payments to third parties. The petition was initially rejected, but was turned around in the state supreme court. Commercial banks were livid. Thrifts could now pay up to 5% interest on what was for all intents and purposes a checking account, where banks could legally offer nothing. Their core means of taking deposits was placed in jeopardy and these "NOW" accounts became a heated topic. Congress decided on a compromise. The "NOW" accounts were permitted first only in Massachusetts and New Hampshire, and then later in five New England states.[1] Both banks and thrifts were able to offer these accounts, but thrifts were elated because they finally had access to checking accounts. This was the first time in history that thrifts were granted expanded powers.

In the later 1970s, as a part of the New England experiment, savings banks in the New England states were allowed to make consumer loans. There was also a similar law in Texas. The results were uninspiring. In Texas, thrifts only had 3% of their assets in consumer loans and in New England the number was even lower, at 0.6%.[2] Because of these small percentages, later advocates of diversification for thrifts would argue that complete expansion of powers, including commercial loans, insurance, etc., were necessary for thrifts to see the true benefits of deregulation.

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[1] Gramble

[2] Eichler, 60

Many years later, by 1998, deregulation was wrapping up and the banking industry was becoming stable once again. Looking back, 45 states and the District of Columbia had all experienced extreme consolidation and a dramatic decline in the number of banking institutions. Only five states, Arizona, Connecticut, Maine, Massachusetts and Nevada were able to counter the tide and retain or increase the number of banks operating within their borders.[1] It doesn't seem like a coincidence that New England states make up three out of the five. It may have been that a slower, more isolated transition eased the states into the deregulation and helped them weather the change. It may also be that these states had always been in closer competition with each other and therefore they were also in a better place to adapt to deregulation.

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[1] Matasar and Heiney, 12

CONTEMPLATION OF DEREGULATION:

The years of the 1970s were a time in America when many things were changing, most specifically politically and economically. The two are perhaps even closely related. The expansionary times of the 60s were contrasted with an economic slowdown characterized mostly by high inflation. Along with this came high interest rates, something that does not usually happen at the same time. This became the notion of stagflation, a compound of the two problems that had negative effects on the economy at the time. The popular opinion soon became that the big government could not stop the downward economic spiral. Productivity was falling and businesses were not doing well. This led to behavior changes by both banks, their depositors and their borrowers. Technology was also starting to open new doors to cost-saving techniques that had never even been dreamt of. At the same time new financial products and services were being developed from within and outside of the banking industry.[1] These started to encroach on the business of banking. Deregulation of the banking industry seemed like a step to take care of all of these problems. Its supporters claimed that an infusion of entrepreneurship and innovation into the industry was all that was needed. The regulations were holding back competition and were therefore holding back true advancement and expansion in banking.

Those lobbying for change and promoting deregulation had many important arguments. The first was that deregulation would lead to diversification and expansion. The demand for mortgages had been reduced because the numbers of these loans were increased

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[1] Burns, 11

through securitization, so it was thought that if thrifts could move into shorter-term lending, they would be better suited to deal with the future. As credit cards, insurance and second mortgages were becoming more popular it was also felt that the more types of banks that dealt in these products, the more competition there would be.[1] Many people also felt that thrift institutions and their federally granted status were simply outmoded. Part of the plea for deregulation was a scheme of modernization. It was a widely held belief at this point in history that "government regulation impedes progress" and many felt that progress in the banking industry was greatly needed.[2]

The stagflation of the 70s also seemed to be on the side of those favoring deregulation. Normally during recessionary times rising interest rates are coupled with falling inflation, but this time it was not the case. The rising interest rates and the uncharacteristic inflation rates were hurting banks. High and unexpected inflation negatively impacts banks but positively affects borrowers. Money paid back to the bank is worth less than it was when borrowed, even when counting the interest rate. The high interest rates were also actually hurting banks at this time. Regulation Q had been enacted in 1933, but did not become restrictive until 1966.[3] By the 70s, interest rates had risen well beyond the ceilings allowed. When this happened, savings migrated out of thrift institutions resulting in a crunch in the mortgage market. This process, called disintermediation, brought money into financial institutions not governed by Regulation Q, who could offer high-rate products.

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[1] Eichler, 60

[2] Ibid.

[3] Conboy and Harrigan, 5

Both thrifts and commercial banks felt the squeeze created by disintermediation. Many proponents of deregulation felt that mortgage demand would go unmet and thrifts would suffer unless they were allowed to take advantage of the rising interest rates.

Lastly, geographic deregulation seemed a necessary counterpart to monetary deregulation. To proponents it seemed only natural to allow geographic diversification along with product and interest rate expansion. It would allow banks a better chance in a more competitive market and keep them from remaining dependent on their local community. Geographic deregulation was also seen as a method of stabilizing the industry once it started to go through rough times. Those in favor argued that banks organized in branch-banking structures have historically tended to be more stable and to experience fewer disruptions from runs and panics than unit banks.[1] Bank branching was also seen as something that could only help the faltering industry.

Opponents of deregulation also had convincing arguments. Most were simply devoted to Regulation Q. They felt that this long standing regulation was the only way for small banks and thrift institutions to attract savings, and without this the nation's demand for home mortgages would go unmet. Also, thrifts themselves argued that they had no experience with the supposed diversifying products. Unfamiliar assets presented unfamiliar risks. They felt that the large banks could more than meet the need for these items and that their market remained in the savings and home loan areas. A large portion of the dissenting deregulation opinion also held the belief that the natural monopolies were still needed.

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[1] Klausner and White, 121

These people judged that economies of scope still existed, even in the changed geographic environment. In order for small banks to remain in business they needed geographic and regulatory protection.

Regardless of the two differing opinions, it was obvious that there was change brewing from within the industry. Most large banks had taken many steps throughout the 1960s to avoid or go outside of Fed regulations. They developed repurchase agreements, used negotiable CDs and commercial paper in efforts to be competitive with high interest rates. In 1972, however, money market mutual funds emerged as an opportunity for consumers to benefit from the market interest rates. These were in essence demand deposits, with check writing abilities (though usually requiring a minimum check size). Customers did have to give up their deposit protection, as these are not insured, but they were able to reap benefits from rising market rates.[1] More and more banks in certain states began issuing negotiable order of withdrawal, "NOW" accounts, which had been offered in New England for a few years. Based on this, and the steps banks were already taking to remain competitive, Congress passed a law in 1980 allowing all thrifts and banks to issue NOW accounts and began a six-year phase-out of Regulation Q interest rate ceilings.[2] Thus began the deregulation of the banking industry.

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[1] Burns, 15

[2] Ibid.

DEREGULATION:

The financial reforms of 1980 did not develop out of thin air. They came as a reaction to and an affirmation of the tactics banks had been utilizing for years. Inflation, high interest rates, money market funds and changes in savings had rendered deposit restrictions obsolete.[1] The 1970s had already seen amendments to the Bank Holding Company Act that broadened the exceptions to the prohibition against bank holding companies engaging in non-banking activities. One of the new amendments was to define a bank specifically as an institution accepting demand deposits and making commercial loans.[2] This allowed non-banks to acquire banks and spin off either deposit taking or loan operations and then continue to work out from under restrictions on banks. Banks and non-banks alike were taking matters into their own hands to utilize and profit from the high interest rates and new products available throughout the 70s.

The Depository Institutions and Monetary Control Act (DIMCA) of 1980 was aimed at phasing out deposit rate ceilings and bolstering the competitiveness of thrift institutions. It instituted five main reforms: it established the Depository Institutions Deregulation Committee to phase out deposit rate ceilings by 1986, it authorized NOW accounts for individuals and nonprofits, it permitted savings and loans to make real estate loans, consumer loans and certain investments, it approved credit card lending and trust activities for savings and loans and finally it allowed thrifts to invest 3 percent of assets in "service" subsidiaries, up from 1 percent. DIMCA blurred the lines even further between commercial

[1] Eichler, 63

[2] Burns, 58

banks and thrift institutions and also served to increase competition even further within the entire banking industry. The most important change to come from this would be the authorization of commercial real estate loans to thrifts.[1] This infused a new aspect of risk for thrift institutions. These new types of loans for thrifts would affect not only the competition of the whole industry, but the geography of banking in the US.

Throughout the 1970s banks had not only circumvented deposit and product regulations, but they also tried to evade geographic regulations. Market pressures for increased services over an increased area led large banks to establish "loan production offices" outside their home states. These were legal since they did not engage in banking and simply arranged for the home office to make the loan or accept the deposit.[2] The difference between this and branching, however, was in essence negligible. As banks and thrifts began to experience trouble in the late 70s and early 80s, bank holding companies were able to acquire banks as well as non-banking subsidiaries in other states. Once they had a presence in another state they were allowed to expand within that state as well. Credit cards were also another way banks started to gain a presence in states other than their home base and compete in a national market. Banks used the same tactics for avoiding geographic regulations as they did for deposit regulations. With the losses of competitive advantage due to all the previous deregulation, banks were looking for new outlets.

Two years after the passage of DIMCA Congress passed the Garn-St. Germain Depository Institutions Act. It broadened the asset powers of thrift institutions and also

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[1] Eichler, 65

[2] Burns, 22

authorized all banks to establish money market deposit accounts which were competitive to money market mutual funds, yet insured by the FDIC.[1] It took one of the first steps toward geographic deregulation when it authorized various actions by regulatory agencies to assist troubled institutions and approved emergency acquisitions across state lines.[2] It seemed to them that removing some of the interstate banking barriers set up over 50 years previous would be less harmful to the system as a whole than the FDIC racking up substantial bailout costs and having to deal with industry disturbances. No one wanted consumers to lose faith in the industry at such a crucial time.

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 for the most part completed the geographic deregulation of the banking industry at the national level. While some intrastate branching restrictions do actually still remain in place, American banks were allowed to avail themselves of the whole nation without any interstate restraints.[3] The last decade of the 20th century then became the era of US banking consolidation. Large banks had been waiting for this chance to expand and gain new markets. Consumers in this modern era were also showing interest in the conveniences that interstate banking could offer. As people moved more and more, banks needed to be able to keep up with their customer sprawl in order to increase, as well as to simply retain their customer base. Banks also wanted to improve their safety and profits by expanding their asset size and diversifying

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[1] Burns, 16

[2] Ibid., 59

[3] Matasar and Heiney, 3

their product lines.[1] In an increasingly international business, American banks needed to compete with international banks that often operated in less regulated and more supportive systems. Lastly, economies of scale were found to have significant importance in banks as there is a decline in average cost per unit of asset with a bank size up to $75 million in assets.[2] It became common thought that larger banks would benefit both consumers and the economy with improved products and lower costs.

The Riegle-Neal Act dealt with five areas of interstate banking and branching activity. It allowed BHCs to acquire banks in all states and states were not allowed to interfere or discriminate against out of state companies. There was, however, also a provision in place to protect banks under 5 years old from out of state acquisition. These BHC acquisitions took place under merger guidelines that did not allow a BHC to acquire more than 30% of the market share in a single state or 10% in the nation. The Riegle-Neal Act also allowed for individual banks to seek regulatory approval to merge across state lines. The same market share provisions were taken into account. The third provision in the act was for the allowance of de novo, meaning new opening, branching into another state if the state approved the activity. Fourth, the act allowed for foreign banks to enter and branch within the United States provided they comply with certain provisions. Lastly, banks from different states were allowed to affiliate.[3] These rules immediately affected the landscape of the

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[1] Matasar and Heiney, 11

[2] Ibid., 12

[3] Ibid., 5-6

American banking industry by encouraging concentration and the expansion of big banks out of the big cities.

Another important factor in the increasing consolidation of banks, outside of only geographic deregulation, was the support by regulators of mergers and acquisitions. Healthy banks taking over or purchasing declining banks was seen as a way to avoid the problems of the previous decades and to reduce the FDIC failure rate. After the end of Regulation Q, many smaller banks had trouble competing to obtain funds and were encouraged to merge or sell in order to remain alive. The Fed and FDIC did not want the bank failures of the 70s to spiral any further into a national banking crisis. The sacrifice of some larger banks gaining market shares was nothing next to the threat of losing even more banks completely to the increased competition. It also became accepted that maybe medium sized banks would be more sustainable in the long run. The regulators realized too, that earlier laws had made banks too dependent on an individual town or community and their economic situation. By allowing banks to expand their geographic area, banks were able to diversify and their risk of failure was dramatically reduced.

At the same time, although the banking industry was undergoing a revolution, a few long standing laws did remain in place. Minimum capital requirements and reserve requirements still exist, as does deposit insurance on most bank services. Numbers have only changed throughout the years as an obvious adjustment for inflation and changes in personal habits, etc. The methods at which banks borrow money from the Fed and each other have also remained constant since the establishment of the Federal Reserve and FDIC. The dual system of having state and nationally chartered banks also remains, although the

ratio of national to state banks has increased dramatically since the Great Depression. States bank law making powers have declined, but each state still holds the prerogative to make many banking decisions under the federal government. The fundamental banking system does still remain in place, only some of the rules and players have changed.

SIMULTANEOUS CHANGES IN THE ECONOMY:

The 1970s and 80s saw an extreme amount of changes throughout the banking industry, and the following decades saw equally as many. Most of these were brought about by banks themselves or by the US government who regulates them, but these were not the only changes that precipitated the alteration of the banking structure. Numerous other economic, political and external factors helped to change American lifestyles and ways of doing business. These had an enormous effect on the entire country as well as the banking industry. Perhaps the most obvious change from the 70s on was the development of computers. Their reach left almost no industry or company untouched.

Computers, and more specifically the invention of the internet, served to basically revolutionize how business was done, and they especially impacted banking. These new technologies made branching especially important to banks because they could spread out their locations while keeping their information central. It also made branches more attractive to consumers because each branch was identical to the main office in regards to the information and services available. Deposits made at any branch were instantly recognized at another branch. Banks could more easily expand within their state and into other states because the internet made distance for the most part irrelevant. From a consumer standpoint, once banking became computerized it was streamlined and simplified. Customer convenience also became an important competitive factor. By the end of the 1980s competition had rendered banks so similar in their offerings and services that customer service became a differentiating factor. People wanted easy access to their money

and this meant many local branches and ATMs. These factors, in addition to new laws, were a large part of the motivation for banks to expand geographically.

Another competitive factor in the geographic expansion of the banking industry was the new development of financial institutions in the late 70s. As the economy was receding, consumers were becoming more savvy with their money. Many were not content to simply let their money sit in a savings account earning minimal interest, or leave the bulk of their money in checking accounts bearing no interest at all. Investing as a way to earn money became more common as consumers wanted to get the most from their money. Financial institutions that were not considered banks grew as a market in response to this demand. Banks in turn faced increasing competition for deposits with which they made their profits. This was some of the impetus behind the development of money market mutual funds and NOW accounts that really changed the ways banks did business. Geographically also, banks were forced to turn away from only their local deposit base and reach as far as they possibly could to gain additional deposits.

Inflation also helped to increase the pressures on banks to expand their products as well as their customer base. As the 1980s opened, inflation rates and interest rates were soaring everywhere as a result of the second oil price shock.[1] The Federal Reserve was trying to contain the mounting inflation with tight monetary policies as the US and the world experienced its worst recession since World War II. Budget deficits in the US helped to keep domestic interest rates also at a relatively high level. This, combined with economic

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[1] Burns, 27

confidence in the later half of the 80s, led to the raise in value of the dollar and a surge in imports. Exports also fell and in a few years America had become the world's largest debtor, also increasing inflation.

Another important outside factor in the geographic deregulation and consequent expansion of the banking industry was the political climate at the time. The Carter and Ford administrations had the prosperous 60s looming over their heads when they came into office during recessionary times. Gerald Ford struggled under the weight of the Nixon scandal and the Vietnam war and was unable to enact any policy measures to counteract inflation or the mounting energy crisis. As Jimmy Carter came into office things were simply getting worse. He had inherited Nixon's price fixing efforts and kept them in place, causing some of the shortages that led to problems in the 70s. He did, however, initiate the launch of deregulation with the airline and trucking industries, which got the ball rolling on further deregulation. Ronald Reagan was the man who came in at the brink of the Savings and Loan crisis with the idea that "big government" was the blame for the problems with the economy. He continued the deregulation of the banking industry, but also was reducing income taxes at the same time. This led to a deep recession in the early 80s which had dire consequences for a majority of the banking industry.

Along with the specific political leanings of the time, there was a general global trend toward privatization of economies. Newly elected governments in the United Kingdom, Canada and France were all ideologically in favor of free market economies. They all started taking steps towards loosening regulations in their own countries. Europe and the United States were also putting pressure on some countries, especially Japan, to remove their

government constraints on foreign financial products and to become less involved in their own banking system.[1] Deregulation was becoming more of an international philosophy that was intended to benefit economies all over the world.

Lastly, the late 1980s and the coming of age of Generation X saw a great change in consumer culture. Giant malls and superstores replaced the local grocery and retail stores as the mainstay of American life. "Bigger is better" became the consumption attitude, and this began to apply even to banks. Customers began to see convenience as a crucial factor in business and banks were looking for whatever they could do to stay competitive. Offering many branch locations and later many ATM locations seemed incredibly important. A bank that was able to offer banking near a customers house and office and places they would travel certainly had an edge. The nostalgia for the local bank with the teller customers had known for years wasn't so appealing any longer. Large banks that could offer a plethora of products under one roof and service a large geographic area became popular and this helped reduce branching taboo. The public began to feel that competition was good for the industry and that fewer geographic restrictions would benefit the consumer.

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[1] Burns, 29

INITIAL EFFECTS OF DEREGULATION:

Deregulation began as an attempt to bring about changes in the banking industry at a time when people in charge thought that things could only get better. The economy was sluggish and it seemed that banks had unrealized potential that could be accessed through deregulation. The initial effects of the new laws of the early 80s, however, really did very little to make things better for a majority of banks and thrift institutions.

The new laws of the late 70s made real estate loans more important for banks and thrifts and as a result became a large part of their lending portfolios. Commercial and private home mortgages were very important to the livelihood of banks in this era. Many had also begun selling their services outside of their local territories to remain competitive. This newfound reliance on mortgages did not leave banks in a good position to weather the first half of the 1980s. Housing starts and sales, both new and existing had peaked in 1978. Starts went from a little over 2 million in 1978 to roughly 1.2 million in 1980, a decline of 36 percent.[1] Sales of new housing fell 40 percent as starts reached postwar lows in 1981 and 1982. This was all exacerbated by the extraordinarily high interest rates, with the prime rate hitting its 20.5% peak in 1981. Rates began falling but not down to previously normal levels. These problems with the housing and real estate markets did not do anything to alleviate the problems that banks and thrift institutions were having already.

The number of savings and loans and savings banks started to fall from 1980 to 1982, with savings banks declining from 323 to 315 and savings and loans having more problems

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[1] Eichler, 69

and falling from 4,613 to 3,825. [1] While total thrift assets actually did continue to rise, earnings fell dramatically for the first time since the Great Depression. The savings and loan industry lost $4.6 billion after-tax in 1981 and $4.3 billion in 1982. Their return on net worth dropped over 15% in both '81 and '82. [2] The problem here was the decline of the interest rate spread that eventually became negative. Mutual funds had lured away high-depositors and forced banks to offer close to market interest rates. The secondary mortgage market reduced yields on loans and banks were taking on adjustable rate mortgages with short-term losses in hopes of long term gains.[3] Banks were receiving rates close to what they were giving, sometimes even lower. Only borrowings from the Federal Home Loan banks enabled them to survive. The combination of external forces and stiff competition due to deregulation did not look good for the thrift industry.

Another change relating directly to deregulation was the continued reliance on securities by commercial banks. Banks were securitizing loans through Ginnie Mae and many other residential mortgage pass through programs as a way to gain a competitive edge or remain competitive in the tighter markets. Large banks were looking to the Eurodollar market and foreign loans for increased securities. Small banks would purchase participation in these foreign loans as another way to securitize. These new developments meant a shift of their income from interest on assets to fees for off-balance sheet services.[4] This started a

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[1] Eichler, 70

[2] Ibid., 71

[3] Carron, 28

[4] Burns, 26

radical change in banks relationships with customers. Individual consumers now had more freedom of choice with which bank they dealt with for different products and services. This was at the same time that interest-free demand deposits were declining in importance to banks. These all served to increase uncertainty for banks in terms of both customer base and future funds.

INDUSTRY REACTION:

The industry had obviously been changing for many years prior to the actual new deregulation laws. Banks and thrifts were reacting to changing economic conditions and in turn laws were made to thwart these actions or help stabilize the industry in the aftermath. After deregulation, though, banks and thrifts started changing now as a result of the new laws and the changing conditions the laws brought with them. The most notable change that deregulation caused was the stiffening of inter-bank competition. Closely related, the new regulations gave banks the first real chance to expand geographically and in essence at all. Banks and thrifts alike took advantage of these legal spurs to make further changes to their business practices.

As early as 1981 banks and thrifts began capitalizing on the new legislation in hopes to make the big changes positive ones. Construction and commercial real estate loans that took advantage of the lower interest rates were the first products to get heavily marketed and in turn their numbers greatly increased. Commercial real estate lending is one of the riskiest and least diversifiable investments that a bank can make.[1] As there were now more players in the loan market with the addition of thrifts and expanded products, competition also increased. The new competition sent banks and especially thrift institutions into risky loan territory where they hoped to make the most profit while charging higher interest rates. Commercial banks were adding to their risk by lending to less credit worthy foreign companies and also by being satisfied with lower net worths.[2] In addition to competition for

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[1] Berger, Kashyap and Scalise, 85

[2] Burns, 99

all the different types of loans, deposits also became scarce with the development of CDs and Money Market accounts. Many banks and thrifts were forced to become content with lower deposit levels. It became important to banks to eke out whatever profits were to be made, wherever they could find them. These early practices, started with little experience of banking in a deregulated industry, would serve to later be the downfall of many banks in many situations.

One positive aspect of the industry reaction to deregulation was the increase in inter-bank and even intra-bank efficiency. As competition for deposits and loans increased, so did competition in other areas of banking. Operational costs became more expensive as banks competed for personnel and raced for the better and newer equipment. Banks sought to increase efficiency within the branch to reduce costs as well as increasing efficiency between banks to better compete and also reduce costs.[1] Banks found new ways to promote and deliver their services that cost them less money as well as invested in more effective computer tools. In 1980 there were less than 20,000 ATMs in service in the United States accounting for less than $50 billion in banking transactions, but by 1994 the number had climbed to 110,000 with ATMs totaling $560 billion in transaction volume.[2] As ATMs were becoming more popular so also was telephone and computer banking. Competition, and admittedly also technological awakening, was spurring many new industry led changes.

Perhaps directly because of earlier deregulation, most banks jumped at the new geographical chances offered to them in the second rounds of new legislation. With

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[1] Rose, 13

[2] Ibid., 12

competition increasing in every other aspect, the removal of the geographic monopoly was almost a relief. Banks used branching to allow them to enter new markets to explore new sources of revenue. They no longer felt the need to be protected, but wanted room to compete in the changing industry and took full advantage of it. Even with the rapid ATM growth, full-service branch numbers rose from less than 46,000 in 1980 to over 60,000 in 1994.[1] Branches became the new key to customer service and expanded product lines. Increases in technology only served to help expand and quicken the pace of the geographical expansion of the banking industry.

Many banks that were affiliated in different states were able to finally merge into one legal entity. By converting one bank into the headquarters and subsequent banks into pure branches, duplicate staffs and tiers were able to be eliminated at great cost savings to all. Reductions in operating costs were also experienced thanks to consolidation of data processing and facilities. Mergers also became popular because of the unique banking characteristic of excess returns for stockholders on both sides of the negotiation table.[2] There was incredible financial incentive all around for banks to merge and cut costs and thus become more competitive.

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[1] Rose, 13

[2] Ibid., 14

BANK FAILURES:

As much as it was the industry reacting to the changes of new legislation, banks and thrifts were basically at the mercy of a revolutionized industry. The mid 1980s were the worst years for the banking industry since the Great Depression. The drastic increase in competition in the industry caused a shake up that not all banks could weather. The only things preventing another national depression were government spending measures and the fact that the service industry made up a greater part of the economy. The government also was using banks as more of an anti-deflationary tool at this time. Banks overzealous loan making increased investment and consumption, in turn helping to counter deflation.[1] In the years following the Great Depression banks failed at rates less than 90 banks a year. The industry and the country itself no doubt expanded in the next 40 years, but bank failures topping 200 per year between 1983 and 1995 were a unique crisis.[2] As profit margins shrank due to increased competition within the industry, there became no margin for error in the business. Risk was an inherent part of the industry, and loans had failed as long as there had been banks, but the cushion was gone. Banks were no longer making as much on the good loans to cover themselves when some loans did go bad. Add to that an increased reliance on risk taking and this led to more problems.

With the decreasing profitability of the traditional banking business, commercial banks were seeking new ways to keep business up. Banks and thrifts alike had many risky loans and were facing incredible competition for deposits. Many of the loans made in the

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[1] Eichler, 87

[2] Mishkin, 273

late 70s were made on the expectation of future growth and rapid inflation. When these were both not experienced to the degree hoped, many home owners and even large business defaulted leaving the banks holding the bag. The existence of deposit insurance increased moral hazard for banks to take on more risky endeavors. Depositors had little incentive to keep banks from making uncertain loans because they were insured against any losses. Also, the continued decline in housing demand was undermining the dependence of banks and thrifts on mortgage loans. Foreign investors were also defaulting in large numbers due to the worldwide recession and the increase in risk that banks took on inevitably led to increases in losses. In efforts to help, the government kept increasing thrift and bank powers by deregulating, but this help ended up backfiring.

The fact that the largest number of banks failed since the 1930s and the huge amount of problems experienced by thrift institutions gave these years the "savings and loan crisis" nickname. The savings and loan industry lost over 8 billion dollars between 1981 and 82.[1] Some commercial banks also closed, and many if not most of those that remained had drastically reduced credit ratings. These included some of the nations largest. The problems unique to thrift institutions were often directly related to the expanded powers granted by deregulation. When their assets were expanded to include commercial loans, real estate loans and consumer loans they were instantly able to take on more risk without the benefit of any prior experience. Banks had been dealing with these types of loans since their establishment and still had problems with risk. S&Ls had little knowledge of how to

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[1] Eichler, 71

accurately gauge risk and as a result got into more trouble with bad loans. In addition to this problem, in the thick of the crisis, as the loans started to go bad, thrifts actually made things worse. As they started losing money from initial bad loans, many thrifts tried to issue more short-term risky loans in an attempt to cover these losses. This nothing-to-lose attitude contributed directly to the excessive risk that caused so many thrift institutions to fail.

An important factor to note is the makeup of the banks that failed. The total number of independent banking organizations fell from 12,463 in 1979 to 7,926 in 1994, for a net loss of 4,537 banks. More specifically, 4,378 institutions classified as "small banking organizations" disappeared during this period.[1] Almost all of the reduction in total banks is explained by the reduction in number of small organizations. Since the gross assets of the industry did not fall during this time, there was a serious shift of assets from small banks to large ones. This just shows that the crisis not only caused the decline of many banks, but it also caused a good portion of the industry consolidation into large organizations. Because of the differences in nature of the two types of banks, the nature of the industry changed as well.

After all these problems it would have made sense to close the insolvent Savings and Loans and stop the cycle of bad loans. Banks and thrifts, however, are not normal business endeavors that can go bankrupt and drop easily out of the industry when they go out of business. Again, thanks to deposit insurance, their customers are protected and the government is required to pay for deposits that a bank cannot cover. This left the

[1] Berger, Kashyap and Scalise, 67

government in a tough position. They had incentive to keep the insolvent banks open if only to prevent them from having to pay out large sums. The regulators chose to maintain a stance of regulatory forbearance in which they refrained from closing indebted banks which was their right.[1] The Federal Savings and Loan Insurance Fund, later abolished in 1989, adopted lower capital requirements and allowed expertise and other intangible assets, called goodwill, to be listed as capital. The main reasons that the FSLIC maintained this stance were due to its close relationship with the thrifts themselves. The FSLIC was created to encourage growth of S&Ls and thus it was difficult for regulators who were very close to these institutions to shut them down. It was also hard for the regulators to admit to such a large scale failure.

The practice of regulatory forbearance did little if anything to help out the failing thrifts. It simply gave them another chance to take bigger risks in hopes of one last big payoff. While some S&Ls did make money, too many did not receive the payout to the risks they had taken. The bigger downside was that failing banks were offering high interest rate deposits and below-market interest rate loans as a last ditch effort. This in turn took a toll on healthy banks. Healthy S&Ls were struggling to compete against failing ones offering impossible rates. This did nothing to help the industry as a whole and just made all banks less profitable. Losses continued to mount year after year as this gambling could no longer be maintained.

[1] Mishkin, 275

FEDERAL REACTION:

The government and the Federal Reserve could see early on that deregulation and the combination of other simultaneous factors had an effect on the banking industry. Banks and thrift institutions alike were changing the methods they used to do business and the products and services they chose to offer. The way the government was deciding to respond to these trends was changing as well. They had the real power to control how they would let the crisis affect the industry.

The 1970s were largely a time of change. The political powers in place by the end of the decade were no longer in favor of keeping the status quo. Deregulation in its onset was seen as a type of reform that would be exactly what everyone thought they wanted. Shaking up the banking industry seemed to be the way to go, initially. It was thought that some new competition would increase the benefits to consumers and help the industry to grow. But it soon became very apparent that while some consumers may be gaining and some banks might be flourishing, a vast majority of banks were losing profits and several were facing insolvency.

The problems the economy itself was having were not helping the government gain the control they desired to see the intended results. The federal government risked looking weak and having the public lose confidence in the economy and banking system if the problems were allowed to exacerbate. They also risked losing control of the whole industry and having to deal with a crisis on par with the Great Depression. Some sacrifices were made, and the landscape of the industry would never look the same again, but thanks to the actions taken by the federal government the banking industry itself was able to remain alive

relatively unscathed except for a small blip on the historical radar. It took the government a few years and a couple of tires, but consumers were able to continue their business as though nothing had happened and confidence in the economy only grew stronger.

One important factor in the government's reaction to the banking problems facing them at this time, the mid-1980s, was the fact that the government is responsible for the economy as a whole as well as banks and also that the banks have a direct effect on the economy in return. In times of economic recession, the government chooses to lower interest rates to get citizens to invest and in essence to increase the money supply. By doing this the government is trying to control inflation and let the economy grow at a sustainable rate, but during this time they were hurting banks. Banks faced even stiffer competition for deposits with lower interest rates and the interest rate spread remained extremely low. When banks have a hard time getting deposits, they are able to offer fewer loans. This also lowers investment and if there are fewer banks in operation it does not help. This put the government in a tough position of trying to balance different interests that all had the potential to affect the economy as a whole.

Banks were not directly controlled by the federal government, but by federal agencies designed to look after different types of banks. The insurance corporations created during the Great Depression were not only for consumer protection. They were established to serve the banks they protected, the federal government and the economy itself. During the banking problems of the 80s, these became conflicting interests. The FSLIC needed to help the banks that were failing, while at the same time not bankrupt the government. They also

did not want to see their sole reason for existence get wiped out of the economy. A rash of bank closings would also not bode well for public opinion of thrifts.

These regulatory agencies were perhaps in actuality too close to the banks. Their initial actions seemed only to compound the problem, not help it. They could have suspended new charters and acquisitions until the so-called crisis passed, but instead they chose to continue as normal. In 1981 and 82 the FSLIC approved 61 new charters in California alone and scores of mergers and acquisitions *between* failing banks who had intentions to gamble with funds.[1] Instead of accepting the bankruptcy of the problem banks, the FSLIC attempted to try and prop up the industry by encouraging relatively healthy ones to purchase or merge with the ailing ones. They not only encouraged consolidation of the industry but thought it would help alleviate the crisis. Fewer, larger firms seemed like they would be more efficient and equipped to deal with the changes that were occurring within the industry. Banks that were so badly off as to not even be able to merge were actually taken over by the FSLIC in order to keep them alive because their liquidation would have more than exhausted the insurance fund.[2] These were often small banks in rural areas. Once helped out of insolvency the FSLIC offered them for sale at modest cost to large city banks who purchased them to extend their presence outside of the cities.

By 1986 the FSLIC stalling tactics were not doing much to help the Savings and Loan crisis and many banks were doing worse. "Just helping out" was not working as bank losses

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[1] Eichler, 76

[2] Ibid., 78

were mounting. The FSLIC was in essence bankrupt. The Reagan administration sought $15 billion to aid the industry, a sum that was only a fraction of the total amount it would cost to close all insolvent S&Ls. Congress, however, in the Competitive Equality in Banking Act of 1987, allowed only $10.8 billion for the FSLIC to borrow.[1] The act included provisions directly encouraging regulatory forbearance (the allowance of failing banks to remain open). Congress did not want to deal with the real problem that bank failures were climbing and loses were mounting well beyond the money they had appropriated.

Two years later the first Bush administration decided to finally take decisive action to close insolvent S&Ls and prevent further problems. His resulting legislation, the Financial Institutions Reform, Recovery, and Enforcement Act, made major new provisions to the regulatory bodies of the banking industry.[2] The FSLIC and Federal Home Loan Bank Board were both eliminated since they had failed in their regulatory tasks. The FDIC then became the sole administrator of federal deposit insurance. This was really one of the final steps toward making thrifts and commercial banks as indistinguishable as they are today. The act also reinstated pre-1982 asset limits for thrifts and created the Resolution Trust Corporation to resolve and sell the real estate of failed institutions. It was actually able to sell over 95% of the actual buildings, most to healthy commercial banks. Some of the capital from the defunct regulatory agencies was also sold to existing banks. While this was a very serious effort to deal with the surmounting problem, there was still no attempt to fix the adverse

[1] Mishkin, 276

[2] Ibid., 278

selection and moral hazard problems created by deposit insurance. They did however initiate a federal study into the matter.

This study was completed in 1991 and resulted in the Federal Deposit Insurance Corporation Improvement Act. This classified banks into 5 groups based on their capital holdings with class 1 being "well capitalized" and class 5 as "critically undercapitalized." The FDIC did also institute a risk-based insurance premium, but it still hasn't proved its validity More than 90% of banks holding over 95% of deposits all pay the same premium. Lastly, the act strengthened the Fed's authority to supervise foreign banks.[1] This left American banks in a better position to compete with international banks and gave them incentive to expand internationally. These new provisions all showed a bias toward the new wave of big banks. The classification system was weighted towards larger banks as well as the new insurance premiums. This distinct "too big to fail" preference that came into play in the early 1990s definitely influenced the following decade of industry consolidation and infiltration by the bank giants.

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[1] Mishkin, 279

GEOGRAPHY OF THE BANKING INDUSTRY IN THE 21ST CENTURY:

The one main result of deregulation and the consequent reactions was a drastically changed banking industry. Gone were the days of the local bank, credit union or savings and loan. By the end of the 1990s and the turn of the 21st century banks in some towns were changing hands a couple of times in one year. A bank that started as a one branch institution in North Carolina was suddenly popping up in cities all over the Midwest, the West coast and New England. More services than ever before were being offered under one roof, instead of simply loans and deposits. Technology revolutionized the way customers interacted with the bank itself and competition became supremely fierce. Many of these things happened to the banking industry, but a good number of the changes seen in the 21st century banking industry were thanks to measures taken by the banks themselves.

One marked difference that banks see in the 21st century is the increased focus on globalization. Many banks have branches in multiple countries or are at the very least affiliated with other banks internationally. This can largely be attributed to the rise in globalization in almost all business industries. The increase in trade with other nations since the 1960s helped this, as did the high interest rates of the 1970s which brought investment from abroad to the United States. The move by the US in the early 70s from fixed to floating exchange rates put pressure on foreign currency against the dollar and tied foreign economies doing business with the US closer to our economy. This made it easier and more efficient to bank in other countries. The speed at which money moves now, in the 21st century, makes a big difference in international banking. The internet and the rapid motion of exchange and interest rates make international banking not only extremely profitable, but

also quick and easy. Lastly, as countries become more integrated in their retail and manufacturing businesses, financial services necessarily becoming more united.[1] A very large number of the world's largest corporations are stationed in multiple countries throughout the globe. Countries are becoming more and more tied together through their economies and banks are unavoidably a part of the package.

An important part of the expansion of the banking industry into an international endeavor is the technology available in the 21st century. Now, more than ever before, the banking industry is the leader in the latest technology. In an increasingly competitive industry banks have turned to technology to entice customers. The ability of certain banks to perform more and more functions via computer or ATM has become a selling point. It also has become a way for banks to cut costs by hiring fewer employees and having their systems be automated. This can also be a double-edged sword. While 40 years ago not dealing with a person would be unheard of, today finding a person to talk to in a bank is somewhat of a joke. Automation seemed, for a while in the late 1990s, to be the wave of the future, but the use of technology seems to have backfired today. More and more companies are advertising their hands-on, people oriented, "old fashioned" approach to banking. It seems that some consumers are fed up with what they consider the overuse of technology and that there are some things that truly cannot be replaced by a computer.

Technology has also had a direct effect on the consumers by leading them to expect more from their banks than ever before. No one is willing to go without access to their

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[1] Burns, 51

money at anytime. Banks are open much longer and expanded hours than ever before and have all kinds of convenience branches in supermarkets and other stores. Whereas 25 years ago customers would go into a branch on Friday afternoon to cash a check that would last them for the weekend, customers today have access to their money relatively anywhere 24 hours a day, 7 days a week. The general public has also become much more savvy in their view of bank services. The corner bank doesn't draw the loyalty it used to as more consumers are able to go online or shop around for the best CD rate or lowest mortgage rate. Having sometimes three or four different banks within blocks of each other helps the customer shop to get the best money for his or her dollar. Consumers now expect to go to the best bank that can help them with their needs as opposed to doing all their business primarily with their local bank.

Added to these changes are the two more obvious, but perhaps overlooked changes in the face of the banking industry: size and location. Larger, interstate and international banks are quickly becoming the norm instead of the exception. This became apparent even in the early years of interstate deregulation. In 1980 the top 10 banks held only 21% of the nations commercial banking assets, but by only 1995 they were approaching 30%.[1] It has only grown since. The actual numbers make it even more clear. In 1990 there were 3,322 banks with under $25 million in assets and only 49 with $10 billion or more. By 1998 the former number had dropped to 1,257 and the latter had grown to 70. Banks with assets between $25 and $100 million have also experienced a drop in number, while banks with

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[1] Rose, 103

over $100 million have seen increases in their numbers.[1] This growth in large banks has been encouraged by regulators since they are seen as more stable and larger banks seem better able to serve customers in the most efficient manner. It is not, in fact, necessarily anti-competitive. Even as the numbers of individual banks have fallen, the largest of the banks have similar market shares and effectively keep each other in check. Also, the Herfindahl-Hirschmann Index and the three-firm deposit concentration ratio both remained relatively stable between 1988 and 1994, showing only modest increases.[2] Competition remains stable, but the industry has seen a dramatic shift in its physical makeup.

Perhaps the more dramatic change and the one having the most effect on the industry of late is the geographic layout. The geographic locations of banks in the 21st century is vastly different than it was 30 years ago. In the 1960s and early 1970s the largest banks were logically in the big cities with the smaller banks in suburban and urban areas. This is not true any longer by any means. The largest banks have infiltrated even some of the smallest towns through purchases and mergers as small banks have closed. This changed geographic distribution is what has the potential to make the largest effect and it has affected different areas of the country differently. Having a single bank service a single community meant that funds came in as deposits from within the one community and they were then redistributed as loans, usually into the same community. Today, however, with interstate banking, deposits could come in from one area and be lent out thousands of miles away. While this issue has been somewhat addressed with the Community Reinvestment Act of

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[1] Matasar and Heiney, 110

[2] Rose, 105

1977, the potential still exists for deposits that come in from poor areas to be lent out in wealthy areas on an opposite side of the country. It also could reduce loans to small businesses. One benefit that regional banking does hold is that it makes banks less dependent on a certain area and therefore less prone to problems. With large banks continually competing and a decent amount of small, local banks still in existence, there really is not a great deal of evidence of geographic dispersion causing problems, though it does still hold the capability to disenfranchise some consumers with poor credit.

Lastly, the financial services and banking industry in the 21st century United States is still the most heavily regulated industry after public utilities.[1] Banks and thrifts have not been set loose to take consumers money and run. Because these businesses are backed by federal deposit insurance, the government still makes an effort to reduce corruption and maintain transparency and confidence in the industry. Customers' privacy is protected as well as their rights to fairness. On products not covered by deposit insurance there are numerous laws protecting against fraud and excessive risk. Banks are audited and must still follow many strict procedures. The US government is not willing to allow such an important part of the American economy into the completely free market.

[1] Sinkey, Jr., 136

CONCLUSION:

The consequences of this great change in the makeup of the banking industry from the Great Depression to the 21st century seem to be positive or negative depending only on which side of the coin you are looking at. Some consumers find the industry changed for the better and these individuals are obviously pleased with the new features. Other customers, however, particularly many who were used to banking many years ago, are less impressed. As new features are added to the industry, it seems inevitable that some must be lost. The question becomes, do these additions outweigh the losses? Since most bank services and industry factors cannot be easily quantified, it is not quite as simple as debits verses credits.

From one specific angle the banking industry looks greatly improved over the past 30-40 years. The number of products available to consumers in 1966 pales in comparison to the plethora of products available today in 2006. At any one bank there are probably three or four different checking accounts that meet different needs, not to mention the new types of accounts like Money Market or NOW accounts. There are fixed-rate and adjustable-rate mortgages as well as reverse mortgages and home equity lines of credit. There are very few financial needs that go unmet in today's banking industry. Most banks have also expanded to offer consumers any and all of these products at one location. There is no need to look very far to find a bank that offers a particular type of product. Lastly, really no one can deny the expansion of convenience within the industry. There are ATMs on nearly every street corner that are beginning to offer more and more services. There is internet banking,

telephone banking, online bill payment and scores of other ways to access money 24 hours a day, 365 days a year.

On the other hand, not everyone sees these new features as benefits to the industry. Coupled with the increase in products is the increase in marketing of these products. No one can walk into a bank without being bombarded with advertising for new or additional products. With increased competition for both loans and deposits, banks resort to trying to develop the latest gimmick to lure customers. Related to this is the addition of fees associated with an increasing number of products as banks scramble to make a profit in the competitive market. The competition has also drastically lowered the number of available bank choices for consumers and many customers see the only banking option as one of the giant banks located in their town and all over the country.

Lastly, despite the increases in convenience and number of services under one roof, there is a distinct sense of loss of the "traditional" banking environment. Customers no longer really frequent just one single branch of a bank and therefore there is a lack of a relationship between the customer and the bank employees. Also, many consumers comparison shop and have different types of accounts with different banks. The level of personal relationships in banks is definitely diminished. Along these lines, the technology associated with banks has grown to humor-worth levels. Speaking on the telephone with an actual person instead of a computer at a bank or other financial institution is, again, something of a national joke. Consumers are growing ever more frustrated with this.

Aside from the opposing consumer benefits and losses, there have also been economic changes that can be better quantified and provide a better conclusion.

Throughout the post-Depression years up until at least the 1960s, there were persistent regional differences in interest rates. There were many reasons for this, with differences in costs of living and the difficulty in moving money being two main ones. Since money could not easily move from one location to another and there were laws regulating where banks could do business, consumers could not take advantage of these interest rate spreads. This market inefficiency exhibited a market failure which is in essence a loss to both the banks and the consumers. As shown in figure 1 of Landon-Lane and Rockoff, the spread between interest rates in the Northeast and West went from almost 4 points in 1880 to around 2 points in the 1950s and less than .5 points in the 2000's. In fact, interest rates rose and sank throughout the late 1990s almost in sync throughout the entire US. In essence, geographic interest rate spreads became smaller as the banking industry spread out geographically. Following the chronological pattern of the interest rates, it can be concluded that the breakdown of geographic restrictions helped in the decline of the regional interest rate spread. That being said, geographic deregulation increased economic efficiency in the banking industry and thus has had a positive overall effect. The industry itself has also managed to grow at a sustainable rate since 1979

It remains to be seen just exactly what the banking industry will be bringing consumers in the upcoming decades. If the past is any indicator, it looks like the business will continue to gain economic efficiency with at least some sort of loss in customer service and personal contact. All evidence points, however, to the fact that banking is incredibly competitive in the 21st century and while competitor numbers may be diminishing, competition itself has remained unchanged. As the banking industry moves into its second

decade relatively free of geographic regulation and free of interest rate restrictions it will hopefully get a chance to compete in a true free market. If this is true, then the banking industry will be continually responding to consumer demands and adapting to the needs and wants of its 21st century customers. The public can expect to enjoy the efficiency and the benefits of this.

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