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REGIONAL INTERSTATE BANKING COMPACTS: ILL-CONCEIVED AND UNCONSTITUTIONAL ANOMALIES

Carter H. Golembe and Max H. Kumin***

A man must be far gone in Utopian speculations who can seriously doubt that if these States should either be wholly dis-united, or only united in partial confederacies, the subdivisions into which they might be thrown would have frequent and violent contests with each other.

Federalist Paper
Number 6, 1787.

[B]e it resolved by the Caucus of New England State Legislatures that a Committee be established comprised of two legislators from each of the New England states . . . for the purpose of pursuing the establishment of a regional banking system in order to strengthen the economic health and vitality of the region.

Resolution of the Caucus
of New England State
Legislatures, 1983.

On January 7, 1985, the Supreme Court of the United States granted a petition for a writ of certiorari in the case of *Northeast Bancorp, Inc. v. Board of Governors*.¹ The central issue in the litigation is whether the Douglas Amendment to the Bank Holding Company Act of 1956² (Act) removes the constitutional barriers confronting states that wish to permit interstate banking on a regional basis. The authors believe that the Douglas Amendment does not remove such barriers, principally the commerce and the compact clauses of the United States Constitution,³

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1. 105 S. Ct. 776 (1985).

2. The Bank Holding Company Act of 1956, as amended, is codified at 12 U.S.C. § 1841 (1982). The Douglas Amendment appears at 12 U.S.C. § 1842(d) (1982).

3. U.S. CONST. art. I, § 8, cl. 3 (commerce clause); U.S. CONST. art. I, § 10, cl. 3 (compact clause).

and further believe that federal legislation should not do so, except perhaps on a temporary and transitional basis.⁴ Fundamental principles of constitutional law dictate the first conclusion; American history and economic analysis dictate the second.

The first section of this Article briefly describes the history of the case. The second and third sections present the constitutional arguments against regional interstate banking compacts under the commerce and compact clauses. The fourth section presents a brief economic analysis of regional arrangements, and the fifth section discusses the public policy considerations that disfavor such arrangements.

I. THE HISTORY OF *NORTHEAST BANCORP*

The Bank Holding Company Act requires bank holding companies, and companies wishing to become bank holding companies, to apply to the Board of Governors of the Federal Reserve System (Board) for prior approval to acquire control of commercial banks.⁵ Section 3(d) of the Act—commonly referred to as the “Douglas Amendment” because it was offered by Senator Douglas of Illinois and added just prior to the final Senate vote in 1956—prohibits the Board from approving the acquisition of a bank located in one state by a bank holding company that has a principal place of business in another state unless the acquisition is “specifically authorized by the statute laws of the State in which such bank is located, by language to that effect and not merely by implication.”⁶ On December 30, 1982, Massachusetts enacted the nation’s first regionally restrictive interstate banking statute (the Massachusetts Act).⁷ The statute permits bank holding companies located in the other five New England states (Connecticut, Maine, New Hampshire, Rhode Island and Vermont) to acquire banks located in Massachusetts if those states extend reciprocal rights to Massachusetts bank holding companies. Subsequently, on June 8, 1983, Connecticut enacted a similar statute, which permits the acquisition of Connecticut banks by bank holding companies located in the other five New England states (the Connecticut Act).⁸ Since then, the states of Florida, Georgia, Kentucky, North Caro-

4. Golembe, *Reflections on Regional Banking: The Courts, and the Congress*, BANKING EXPANSION REP., Nov. 19, 1984, at 1.

5. See 12 U.S.C. § 1842(a) (1982).

6. See 12 U.S.C. § 1842(d) (1982).

7. MASS. GEN. LAWS ANN. ch. 167A, § 2 (West 1984).

8. 1983 Conn. Acts 83-411 (Reg. Sess.). Rhode Island has enacted a similar, regional reciprocal statute. 1983 R.I. Pub. Laws ch. 201 (codified at R.I. GEN. LAWS §§ 19-30-1, 19-30-2 (Supp. 1984)). The regional restriction of the Rhode Island statute expires on July 1, 1986.

lina and South Carolina have passed reciprocal legislation creating a southeastern banking region, and it is reported that at least twenty states will consider various forms of regionally limited interstate banking legislation in 1985.

Shortly after the enactment of the Massachusetts and Connecticut statutes, three merger agreements were concluded between Massachusetts and Connecticut bank holding companies.⁹ The companies applied for, and received, the Board's approval of the transactions.¹⁰ The applications were protested before the Board by the petitioners now before the Supreme Court. These petitioners are Northeast Bancorp, Inc., a Connecticut bank holding company, Union Trust Company, its wholly-owned subsidiary, and Citicorp, a New York bank holding company. Subsequently, the petitioners appealed the Board's orders approving the applications to the United States Court of Appeals for the Second Circuit, which upheld the orders.¹¹ The court held that Congress, in the Douglas Amendment, had authorized Massachusetts and Connecticut to enact their interstate banking statutes and consequently, that the statutes did not violate the commerce clause.¹² The court found that the state statutes at issue did not violate the compact clause because they did not "encroach upon or interfere with the supremacy of the United States."¹³ The petition for a writ of certiorari followed.

II. THE COMMERCE CLAUSE BARRIER TO REGIONAL BANKING

In *Federalist Paper Number 7*, Alexander Hamilton foresaw that,

9. Bank of New England Corporation, a Massachusetts bank holding company, agreed to merge with CBT Corporation, a Connecticut bank holding company; Hartford National Corporation, a Connecticut bank holding company, agreed to acquire Arltru Bancorporation, a Massachusetts banking holding company, and Bank of Boston Corporation, a Massachusetts bank holding company, agreed to acquire Colonial Bancorp, Inc., a Connecticut bank holding company.

As of December 1984, the only other definitive agreement to merge announced under regional interstate statutes that have already been enacted has been between Sun Banks, Inc., a Florida bank holding company, and Trust Company of Georgia, a Georgia bank holding company.

10. Bank of New England Corp., 70 Fed. Res. Bull. 374 (1984); Hartford Nat'l Corp., 70 Fed. Res. Bull. 353 (1984); Bank of Boston Corp., 70 Fed. Res. Bull. 524 (1984).

11. *Northeast Bancorp v. Board of Governors*, 740 F.2d 203 (2d Cir. 1984), *cert. granted*, 105 S. Ct. 776 (1985). The appeals were taken pursuant to 12 U.S.C. § 1848 (1982).

12. 740 F.2d at 208.

13. *Id.* at 209 (quoting and citing *United States Steel Corp. v. Multistate Tax Comm'n*, 434 U.S. 452, 471 (1978); *New Hampshire v. Maine*, 426 U.S. 363, 369 (1976); *Virginia v. Tennessee*, 148 U.S. 503, 519 (1893)). The court also held that the statutes at issue did not violate the equal protection clause, *id.* at 209-10, but the petitioners have not raised that argument before the Supreme Court and it will not be discussed there.

absent passage of a unifying constitution, "[t]he competitions of commerce would be [a] fruitful source of contention. . . . Each State, or separate confederacy, would pursue a system of commercial policy peculiar to itself. This would occasion distinctions, preferences, and exclusions, which would beget discontent."¹⁴ Hamilton expressed the fears that had been an immediate reason for calling the constitutional convention and drafting the commerce clause, which grants Congress the authority to "regulate Commerce . . . among the several States."¹⁵

Implicit in this grant of authority is a limitation upon the power of the states to regulate interstate commerce, as the Supreme Court has recognized at least since *Cooley v. Board of Wardens*.¹⁶ The Court has stated that the "purpose of the Commerce Clause was to create an area of free trade among the several States."¹⁷

Congress may, of course, authorize the states to regulate interstate commerce in ways that, absent such authorization, would be inconsistent with the commerce clause.¹⁸ Thus, the first issue in the *Northeast Bancorp* case is whether, through the Douglas Amendment, Congress has authorized the states to enter into regional banking arrangements.¹⁹ In cases where states have claimed congressional authorization for otherwise impermissible interference with interstate commerce, the Supreme Court has generally looked for an express statement of congressional policy before finding that the state regulation is permissible.²⁰ Last term,

14. THE FEDERALISTS No. 7, at 116 (A. Hamilton) (B. Wright ed. 1961).

15. *Hughes v. Oklahoma*, 441 U.S. 322, 325 (1979).

16. 53 U.S. (12 How.) 299 (1852).

17. *McLeod v. J.E. Dilworth Co.*, 322 U.S. 327, 330 (1944).

18. *See, e.g., Western & S. Life Ins. Co. v. State Bd. of Equalization*, 451 U.S. 648, 652-53 (1981); *Prudential Ins. Co. v. Benjamin*, 328 U.S. 408, 429-31 (1946).

19. It is clear that, absent such congressional authorization, regional arrangements would violate the commerce clause, as the Solicitor General has conceded. Respondent's Brief against Petition for Writ of Certiorari at 5, *Northeast Bancorp v. Board of Governors*, 740 F.2d 203 (2d Cir. 1984), *cert. granted*, 105 S. Ct. 776 (1985) (citing *Lewis v. BT Inv. Managers, Inc.*, 447 U.S. 27, 36 (1980)) [hereinafter Briefs cited without case name]; *City of Philadelphia v. New Jersey*, 437 U.S. 617, 624 (1978); *Great Atl. & Pac. Tea Co. v. Cottrell*, 424 U.S. 366, 370-71 (1976). When confronted with claims that state regulation affecting interstate commerce is unconstitutional, the Supreme Court has employed two tests. If the challenged regulation is determined to be outright protectionism, a "virtually *per se* rule of invalidity has been erected." *Lewis v. BT Inv. Managers, Inc.*, 447 U.S. 27, 36 (1980) (quoting *City of Philadelphia*, 437 U.S. at 624). If the regulation equally affects interstate and local businesses, it may survive if "narrowly drawn." *Id.* The focus of inquiry is upon the probable effect of the statute. *Id.* at 37.

20. *See, e.g., Western & S. Life Ins. Co. v. State Bd. of Equalization*, 451 U.S. 648, 653 (1981) (McCarran-Ferguson Act). The McCarran-Ferguson Act, 59 Stat. 33 (codified in scattered sections of 15 U.S.C.), is the classic example of an express congressional statement of such intent. Section 1 of the Act states:

Congress hereby declares that the continued regulation and taxation by the several

the Court clarified this requirement, stating that:

[F]or a state regulation to be removed from the reach of the dormant Commerce Clause, congressional intent must be unmistakably clear. The requirement that Congress affirmatively contemplate otherwise invalid state legislation is mandated by the policies underlying dormant Commerce Clause doctrine. It is not . . . merely a wooden formalism. The Commerce Clause was designed "to avoid the tendencies toward economic Balkanization that had plagued relations among the colonies and later among the States under the Articles of Confederation."²¹

Regarding state statutes permitting interstate acquisitions on a regional basis only, congressional intent as expressed in the Douglas Amendment and the circumstances surrounding its passage can hardly be deemed "unmistakably clear." The language of the statute simply grants states the right to lift the federally imposed barrier to interstate acquisitions. Not a word of the statute suggests that in acting to lift the barrier, a state might discriminate between states it deems desirable as trading partners and those it does not. The notion that states may construct preferential trade regions and protect their citizens from competition resulting from free access to local markets has repeatedly been rejected by the Court.²² Furthermore, while regional state statutes may fall within the literal wording of the Douglas Amendment, it is quite clear that they fail to pass an integral part of the test described above. They were not "affirmatively contemplated" by Congress when it passed the Douglas Amendment.

The Douglas Amendment was first offered on the floor of the Senate

States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.

15 U.S.C. § 1011 (1982). Section 2(a) states: "The business of insurance . . . shall be subject to the laws of the several States which relate to the regulation or taxation of such business." 15 U.S.C. § 1012(a) (1982). The legislative history of the statute contains an equally clear expression of congressional intent. Consequently, the Supreme Court has often held that it authorizes otherwise invalid state action. *Western & S.*, 451 U.S. at 654-55. See generally *Prudential Ins. Co. v. Benjamin*, 328 U.S. 408, 425-28 (1946).

21. *South-Central Timber Dev., Inc. v. Wunnicke*, 104 S. Ct. 2237, 2242 (1984) (quoting *Hughes v. Oklahoma*, 441 U.S. 322, 325 (1979)).

22. *E.g.*, *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511 (1935) (state price control scheme favoring in-state producers violated commerce clause); *Great Atl. & Pac. Tea Co. v. Cottrell*, 424 U.S. 366 (1976) (mandatory reciprocity requirement for in-state sale of milk produced out-of-state violates commerce clause); *Dean Milk Co. v. City of Madison*, 340 U.S. 349 (1951) (same for geographic production requirement). See generally *H.P. Hood & Sons, Inc. v. DuMond*, 336 U.S. 525 (1949).

and adopted after only brief debate.²³ The sparse legislative history is focused primarily on the Amendment's intended effects of preventing a concentration of resources in banking.²⁴ The Amendment established a de facto prohibition of interstate banking,²⁵ for at the time of its adoption not a single state statute permitted the entry of out-of-state bank holding companies.²⁶ Nowhere did the discussion touch upon the specific issue of regionalism, or even upon the broader issue of the fashion in which states might choose to exercise their power under the Amendment. Indeed, one Senator pointed out that the statute required discrimination in interstate commerce, and left to the states the task of correcting it.²⁷ Although the absence of specific discussion of the point during the debate makes it impossible to determine Congress' actual intention, it is unlikely that the correction contemplated was to be discriminatory itself. Such a conclusion would reduce Congress' authority under the commerce clause to little more than the "wooden formalism" the Supreme Court has stated it is not, for it would allow the states to install discriminatory trade arrangements without the scrutiny of the only body granted constitutional authority to authorize them.²⁸

The Supreme Court recently explained that the policies underlying the dormant commerce clause doctrine require that "all segments of the country are represented" in situations where the claim is made that otherwise invalid state legislation has been congressionally sanctioned. This ensures that there is "significantly less danger that one State will be in position to exploit others."²⁹ Observing that "[u]nrepresented interests will often bear the brunt of regulations imposed by one State . . . on persons or operations in other States,"³⁰ the Court stated that "[a] rule requiring a clear expression of approval by Congress ensures . . . a collective decision."³¹

In other words, while the proponents of discriminatory state legisla-

23. 102 CONG. REC. 6856-63 (1956). There is no committee report or other significant legislative history.

24. *Id.* at 6857 (statement of Sen. Douglas).

25. *Id.* at 6860 (Sen. Douglas remarked: "[T]he immediate practical effect would be to bar the expansion of bank holding companies across State lines.") See also statement of Sen. Bricker, *id.* at 6861 ("an absolute prohibition against future expansion by bank holding companies").

26. *Id.* at 6860 (statement of Sen. Douglas).

27. *Id.* (statement of Sen. Bennett). It is noteworthy that Congress has considered, and failed to pass, an explicit federal authorization of interstate banking. S. 2851, 98th Cong., 2d Sess. §§ 1001-1007, 130 CONG. REC. 11, 162-80 (1984).

28. South-Central Timber Dev., Inc. v. Wunnicke, 104 S. Ct. 2237, 2243 (1984).

29. *Id.*

30. *Id.*

31. *Id.*

tion may muster enough votes to secure congressional blessing of their policies, the Constitution requires that the democratic process be adhered to in the undertaking. The need for affirmative congressional approval is heightened by the fact that regionally restrictive interstate banking legislation may significantly alter the nation's banking structure. The importance of the federal government's policy objectives, discussed below, dictates that congressional authorization of regional interstate compacts not be implied lightly.³²

III. THE COMPACT CLAUSE BARRIER TO REGIONAL BANKING

The compact clause of the United States Constitution provides: "No state shall, without the Consent of Congress . . . enter into any Agreement or Compact with another state . . ." ³³ The Supreme Court has construed the clause so as to cover all types of agreements, formal and informal,³⁴ that have the potential³⁵ to increase the political power of the compacting states or to encroach upon or interfere with the supremacy of federal power.³⁶

There is little question that the Connecticut and Massachusetts Acts together constitute an "arrangement or compact" within the meaning of the clause. The Board of Governors of the Federal Reserve System and the Second Circuit assumed so, and few of the parties have seriously contested the issue.³⁷ It is undisputed that Congress has not specifically authorized the Massachusetts and Connecticut Acts, or any other regional compact now in existence or contemplated. Hence, the principal objection to regional compacts under the compact clause is that they have the potential to increase both the economic and political power of the compacting states and impinge upon federal authority.³⁸ Such compacts rep-

32. *Cf. id.* at 2243, n.7.

33. U.S. CONST. art. I, § 10, cl. 3.

34. *United States Steel Corp. v. Multistate Tax Comm'n*, 434 U.S. 452, 470-71 (1978).

35. *Id.* at 471.

36. *Id.* at 472. *See also* *New Hampshire v. Maine*, 426 U.S. 363, 369 (1976); *Virginia v. Tennessee*, 148 U.S. 503, 518 (1893).

37. Appendix to the Order Approving the Application of Bank of New England Corporation to merge with CBT Corporation. 70 Fed. Res. Bull. 380 (1984); *Northeast Bancorp v. Board of Governors*, 740 F.2d 203, 209 (2d Cir. 1984), *cert. granted*, 105 S. Ct. 776 (1985); Respondent's Brief against Petition for Writ of Certiorari, *supra* note 19, at 11. One month after Massachusetts passed its interstate statute, the Caucus of New England State Legislatures, the New England Governors' Conference, and the New England Congressional Caucus jointly sponsored a conference "to explore the concept of a New England interstate banking system." Petitioner's Brief for Writ of Certiorari, *supra* note 19, at A162-A168. Connecticut passed its interstate statute four months later.

38. If the Court holds that the Massachusetts and Connecticut Acts violate the commerce clause, then it need only conclude that together they constitute an "agreement" or "compact"

resent state-initiated interference with the long-standing and overriding exercise of federal supremacy over the nation's banking system. Consequently, unless and until the existence of regional compacts is sanctioned by Congress, they remain constitutionally impermissible.

The fact that banks are subject to the oldest and most pervasive system of regulation applied to any industry in this nation is testimony not only to the central role that such institutions play in the economy, but also to the paramount concern that government has displayed in the banking industry.³⁹ As monetary institutions, commercial banks are the vehicles through which the bulk of the nation's money supply is created and held. Consequently, the government necessarily has a deep interest in the soundness and stability of the banking system. As the primary mobilizers and allocators of credit, banks are also subject to the government interest attached to these functions. Over time, government has become increasingly concerned with the uses to which bank credit is put.

In the almost two hundred years since the adoption of the United States Constitution, no subject has excited more political emotion or raised more sensitive issues of federal and state prerogatives than banking. It was probably for this reason that neither banks nor the business of banking was mentioned by the drafters of the Constitution. The subject was so controversial as to raise the specter of rejection of the new Constitution should it be addressed. Yet, in the economic and financial system that subsequently evolved, the exercise of the monetary powers of government and, more specifically, control of the banking system has often raised issues of constitutional significance. This is the case today with regional interstate banking compacts.

There has never been any question that the monetary power—essentially control over the circulating medium—was and is a significant element of government sovereignty. As Bray Hammond put it, in his classic study of American banking: “In terms of the Constitution and of common sense, control of the monetary system irrefragably belonged to

within the meaning of the compact clause to hold that the Acts violate that clause as well. By recognizing that the grant of authority to Congress in the commerce clause implies a limitation of power upon the states, *see supra* note 16, dormant commerce clause doctrine requires that federal supremacy in the regulation of interstate commerce be acknowledged. Consequently, multistate compacts that violate the commerce clause must of necessity violate the compact clause. *Cf. United States Steel Corp. v. Multistate Tax Comm'n*, 434 U.S. 452, 473 (1978). Of course, congressional authorization of the compact would cure the constitutional defects under both clauses.

39. *See Lewis v. BT Inv. Managers, Inc.*, 447 U.S. 27, 38 (1980) (“An impressive array of federal statutes regulat[es] . . . that provision of banking services [and] the formation of banking organizations . . .”).

sovereignty"⁴⁰ Rather, the question was where that sovereignty lay—in the newly organized federal government or in the states. Was the federal government a mere creation of the states, limited to the exercise of the powers specifically granted it, while the states, remaining sovereign, were the holders of all powers not relinquished? Or, was the federal government sovereign, fully capable of exercising all of the indicia of sovereignty, whether explicitly or implicitly based on the words of the Constitution? The first Secretary of the Treasury, Alexander Hamilton, advanced the latter position when he urged President Washington to approve the chartering by the federal government of the Bank of the United States in one of the most significant monetary events in the nation's history:

[T]his general principle is inherent in the very definition of government, and essential to every step of the progress to be made by that of the United States, namely: That every power vested in a government is in its nature sovereign, and includes, by force of the term, a right to employ all the means requisite and fairly applicable to the attainment of the ends of such power, and which are not precluded by restrictions and exceptions specified in the Constitution, or not immoral, or not contrary to the essential ends of political society.⁴¹

It was Thomas Jefferson, among others, who took quite the opposite view in opposing, unsuccessfully, the federal government's first entry into the banking business, an entry probably intended to have, and certainly having in fact, the effect of exercising control over state banking institutions.

The matter of government sovereignty and the monetary power was not settled in 1791. Several decades later, in the early 1830's, the pendulum swung quite far in the other direction when President Jackson, with the support of agrarians and business entrepreneurs, destroyed the second Bank of the United States. To be sure, Chief Justice John Marshall, in *Craig v. Missouri*, had made it quite clear in 1830 that, under the Constitution, the states could not furnish the nation's circulating medium through the issuance of bills of credit, or by instruments similar in nature but passing under a different name.⁴² His decision was thought to foreshadow the eventual end of state chartered banks—institutions that obviously were creatures of the states and that were, in fact, providing much of the nation's circulating medium in the form of bank notes and depos-

40. B. HAMMOND, *BANKS AND POLITICS IN AMERICA* 723 (1957).

41. Opinion of Alexander Hamilton, Feb. 23, 1791, in *DOCUMENTARY HISTORY OF BANKING AND CURRENCY IN THE UNITED STATES* 279 (H. Krooss ed. 1969).

42. 29 U.S. (4 Pet. 410 (1830)).

its. Yet, in 1837, after Chief Justice Marshall's death, the Supreme Court in *Briscoe v. Bank of the Commonwealth of Kentucky* held that notes issued by state banks and used as circulating medium were not violative of the United States Constitution.⁴³ Because the charter of the second Bank of the United States had expired in 1836 and was not renewed by the federal government, *Briscoe* meant that, for all practical purposes, the monetary power of the government had been lodged finally in the states, where it resided for the next three decades.

It was probably inevitable that the pendulum would swing again, returning to Hamiltonian doctrine. The immediate cause for this event was the Civil War. The North entered the war without a monetary system of its own, and indeed, with little if any control over the state banking system. It ended the war with its own banking system in place and had set the scene for restoration to the federal government of that element of sovereignty implied in power over the circulating medium. That power has resided in the federal government ever since.

The federal government created its own bank system, national banks, in 1863. During the war it issued its own currency, the so-called Greenbacks, which the Supreme Court in 1870 found to be constitutional in the *Legal Tender Cases*.⁴⁴ The *Briscoe* decision of 1837 was essentially overturned or at least ignored in 1869 when the Court held that a prohibitive tax laid by Congress on state banknotes, in an effort to assure the primacy of the federal circulating medium and to eliminate the state banks, was constitutional.⁴⁵ It would seem that even the existence of state banks is a matter of federal grace rather than constitutional privilege. A prohibitive tax on the note liabilities of state banks could be applied as well to the deposit liabilities of the same institutions.

In any event, Congress in 1913 established a central bank and in 1933 created an agency of the federal government to insure bank deposits. The constitutionality of the central bank was settled many years before, in *McCulloch v. Maryland*.⁴⁶ The constitutionality of deposit insurance was upheld in *Doherty v. United States*.⁴⁷

It is of interest, and of some possible significance to the issues raised by regional compacts, that the courts have gone beyond the narrow monetary clause of the Constitution to fix the constitutional locus of the mon-

43. 36 U.S. (11 Pet.) 257 (1837).

44. 79 U.S. (12 Wall.) 457 (1870).

45. *Veazie Bank v. Fenno*, 75 U.S. (8 Wall.) 533 (1869).

46. 17 U.S. (4 Wheat.) 316 (1819).

47. 94 F.2d 495 (8th Cir. 1938).

etary power held and exercised by the federal government. In *Norman v. Baltimore & O.R.R.*, for example, the Supreme Court stated:

The broad and comprehensive national authority over the subjects of revenue, finance and currency is derived from the aggregate of the powers granted to the Congress, embracing the powers to lay and collect taxes, to borrow money, to regulate commerce with foreign nations and among the several States, to coin money, regulate the value thereof, and of foreign coin, and fix the standards of weights and measures, and the added express power "to make all laws which shall be necessary and proper for carrying into execution" the other enumerated powers.⁴⁸

It is beyond question that there are national economic goals to be obtained by a properly functioning monetary system. The Employment Act of 1946⁴⁹ legislatively declared economic goals, which were expanded in the Full Employment and Balanced Growth Act of 1978 (Humphrey-Hawkins Act).⁵⁰ The latter calls upon the President, the Congress and the monetary authority to achieve "national economic priorities and objectives."⁵¹ Nor is there any question of the importance of the banking system, and the structure of that system, to the achievement of such goals. The Supreme Court was explicit on this point in *United States v. Philadelphia National Bank*⁵² when, in dealing with a significant structural question involving the proposed merger of two Pennsylvania banks, it stated:

Banking operations are varied and complex; "commercial banking" describes a congeries of services and credit devices. But among them the creation of additional money and credit, the management of the checking-account system, and the furnishing of short-term business loans would appear to be the most important. For the proper discharge of these functions is *indispensable to a healthy national economy*, as the role of bank failures in depression periods attests.⁵³

It is against this background that the sovereign role of the federal government in shaping the banking structure is seen most easily. One must begin with the manner in which the federal government has shaped

48. 294 U.S. 240, 303 (1935) (citing *Julliard v. Greenman*, 110 U.S. 421, 439-40 (1884)).

49. Pub. L. No. 79-304, ch. 33, 60 Stat. 23 (1946).

50. Pub. L. No. 95-523, 92 Stat. 1887 (1978) (codified in scattered sections of 15 U.S.C.).

51. *Id.*

52. 374 U.S. 321 (1963).

53. *Id.* at 326-27 (emphasis added) (footnote omitted).

the present structure. As evidenced by the McFadden Act of 1927, as amended in 1933, the federal government concluded that its own national banking institutions, as well as those state-chartered banks that had joined the Federal Reserve System, should not operate branches outside of the state in which each was located.⁵⁴ Then, in an awkward effort to provide parallel treatment for those banking organizations designated as bank holding companies, Congress in 1956 enacted the Bank Holding Company Act. The Act directed that the Federal Reserve Board, an agency of the federal government, should not approve the acquisition of a bank by a bank holding company if such bank was not located in the state in which the holding company did its principal business.

An incidental effect of these federal decisions was to place each state in a position to fashion its banking structure, that is, branching or no branching, holding company banking (one-bank or multi-bank) or no holding company banking. To be sure, it was always understood that the federal government could reverse this arrangement any time that it chose, at least for its banks and its agencies. Nor were the states given unrestricted authority over the banking structures within their own territories. The Bank Merger Act of 1966, for example, placed in the federal banking agencies authority over bank mergers.⁵⁵ Most recently, the Garn-St Germain Act of 1982 permitted federal agencies to arrange interstate acquisitions of failing, major commercial banks.⁵⁶

This federal statutory structure of geographic restraints on banking is founded on a variety of motives, most of which will not pass the test of economic analysis. These motives are, nonetheless, real, and range from a desire to preserve the soundness of the banking system by restricting competition to a fear of large concentrations of banking resources. Whatever the motives, the effect of geographic restraints on the banking structure is profound. The federal government, historically at least, has opted for a pluralistic or fragmented banking structure by taking the actions noted above, knitting the system together through a federal pro-

54. 12 U.S.C. § 36(c) (1982).

55. 12 U.S.C. § 1828(c) (1982).

56. 12 U.S.C. § 1823(f) (1982). Section 116(4)(i) of the Garn-St Germain Act provides that "[n]otwithstanding section 3(d) of the Bank Holding Company Act of 1956 or any other provision of law, State or Federal, or the constitution of any State," in the case of a failed commercial or failing mutual savings bank, where the bank has assets in excess of \$500 million, the FDIC may arrange for its acquisition by an out-of-state bank holding company. In selecting a purchaser, preference must be accorded possible in-state purchasers, following certain criteria set forth in the statute. If an out-of-state purchaser is selected, preference must be accorded to those in contiguous states.

gram of deposit insurance. But these have been federal decisions, implemented by federal law, and supervised by federal agencies.

It is this demonstrated exercise of federal authority that is encroached upon by regional interstate compacts which act to enhance state power at the expense of the federal government.⁵⁷

IV. ECONOMIC ANALYSIS OF REGIONAL ARRANGEMENTS

Regional interstate compacts are clearly offensive to economic principles. Their effect is to create a kind of "common market" for interstate banking that benefits banking institutions within the region and penalizes banking institutions outside the region. Compacts also harm banking institutions within the region with businesses oriented toward excluded states. The benefits and penalties are easily illustrated.

Absent the formation of a new banking region, bank holding companies in any state in the Union may conduct a variety of banking businesses in any other state, subject only to an inability to do a deposit business through a bank subsidiary. Thus, for example, prior to passage of the statutes being challenged in the *Northeast Bancorp* case, bank holding companies headquartered in Massachusetts and New York were on an equal competitive footing in Connecticut. They could do any kind of banking or bank-related business permissible under federal and state law, for out-of-state banks or bank holding companies, but could not combine these activities with a deposit-taking business. Such a combination, heretofore available in Connecticut only to Connecticut banks, is a powerful competitive tool. But with passage of the Massachusetts and Connecticut Acts, Massachusetts bank holding companies are provided with the new competitive tool while those in New York are denied it. Thus, even though there may be a much closer economic relationship between Connecticut and New York than between Connecticut and Massachusetts when it comes to local banking markets, it is the New York bank holding companies that are suddenly placed in a subordinate competitive position in Connecticut as compared with Massachusetts companies.

In effect, the Connecticut and Massachusetts legislatures, acting in concert, have decided that certain banking institutions will grow faster than would otherwise have been possible, while certain other banking institutions will grow more slowly than would otherwise have been possible. The only distinction is whether they are located within or outside of the protected geographic area. Even within the protected area, the two

57. *United States Steel Corp. v. Multistate Tax Comm'n*, 434 U.S. 452, 473 (1978).

legislatures have altered significantly the relative competitive positions of banking organizations, enhancing the growth prospects of banking institutions whose markets and opportunities lie within the protected area, and diminishing, relative to their competitors, the competitive position and future growth prospects of banks whose markets and opportunities are directed toward the excluded states.

The issue is broader, of course, than just the relative positions of bank holding companies in the three named states. Wherever any group of states decides to set up a common market and exclude some states from that market, the effect will be to penalize the business concerns in the excluded states. This in turn must have an adverse impact on the economic development of the excluded states. In the design of the American banking system, parochial interests will likely always be an important consideration. However, parochialism that goes so far as to adversely affect the economic welfare of other states or the achievement of national economic goals, obviously must be avoided.

Some proponents of regional compacts have attempted to justify limiting interstate acquisitions on the basis of an economic affinity among the included states, which somehow supports the exclusion of other states.⁵⁸ However, in a fundamental sense, whether or not there is an economic affinity among several states is irrelevant. The fact that two or more states may share some common interests or have similar characteristics does not, by itself, justify a combination of those states to the detriment of other states or the national interest. Although there are certain rights reserved to the states, it is doubtful that unlimited control over the banking system is one of them. Even if it were, there is not, as far as we are aware, any such concept of "regional states' rights," particularly when based on so nebulous a concept as regional affinity.

That the concept is nebulous is self-evident. All fifty states share some common interests and characteristics; at the other extreme, no state is precisely like any other. However, there are no accepted guidelines that an economist can use to measure objectively or to evaluate regional affinity, based on clusters of states, in terms of the business of banking. It is for this reason that, when dealing with banking, the courts and economists alike have looked to the realities of the market when measuring the impact of any significant structural change.

One serious effort to recognize regional banking configurations was made by the federal government when it established a Federal Reserve

58. *See, e.g.*, Report to the General Assembly of the State of Connecticut of the Findings and Recommendations of the Commission to Study Legislation to Limit the Conduct of Business in Connecticut (Jan. 5, 1983).

district for each of the twelve Federal Reserve Banks and, in addition, provided that the key elements of central bank authority would be exercised on a district or regional basis.⁵⁹ Reality, in the form of recognition of the existence of a nationwide banking system, eventually prevailed so that today (and for many years now) open market operations, the determination of reserve requirements, and (for all practical purposes) discount rate changes are centered in the Board of Governors in Washington. For the remaining day-to-day operational interaction between the Federal Reserve and member banks, the Federal Reserve districts have proven useful, and in this context it is interesting to note that several such districts embrace only portions of individual states. For example, Fairfield County in Connecticut is not included with the remainder of New England in the Boston Federal Reserve District but, instead, is in the New York District.

Political boundaries rarely are coterminous with economics or banking markets. Whether one selects a county, a state, or, for that matter, a group of states as the area in which a financial institution may establish offices or own bank subsidiaries, some customers will be inconvenienced. The extent of this inconvenience and its significance will vary from one area to another, but when one places an artificial barrier within a metropolitan area, the impact is likely to be substantial. As Alan Grunewald pointed out at a Federal Reserve conference on banking structure:

The banking activities of many people are restricted because they live, shop and work in metropolitan areas divided by state boundaries. People living in one state, but working and shopping in another state cannot do business at the same bank where they live and where they work and shop. To bank in both places requires affiliation with at least two banks. It is not fruitful to continue to restrict the natural development of banking markets across state lines by prohibitions against interstate banking.⁶⁰

It has long been recognized that metropolitan areas, particularly those encompassing parts of two or more states, merit special consideration in banking structure deliberations. As a matter of fact, a half century ago, Senator Carter Glass advocated interstate branching up to fifty miles from the place where the parent was located.⁶¹ A quarter century

59. 12 U.S.C. § 222 (1982).

60. Grunewald, *Economic Necessity for Interstate Banking*, in PROCEEDINGS OF A CONFERENCE ON BANK STRUCTURE AND COMPETITION 232, 233 (May 3-4, 1979) (Federal Reserve Bank of Chicago).

61. See S. REP. NO. 584, 72d Cong., 1st Sess. 11, 16 (1932).

later, the Commission on Money and Credit called for branching within "trading areas" irrespective of state laws. The term trading area was defined as "a geographical area that embraces the natural flow of trade from an outlying geographical territory to and from a metropolitan center."⁶² While these recommendations were far ahead of their time, they quite appropriately recognized the importance of providing banking service throughout a metropolitan area even though it happens to cross state lines.

An example with particular relevance to the instant litigation is the New York-Northern New Jersey-Long Island area, NY-NJ-CT CMSA (Consolidated Metropolitan Statistical Area), which contains sections of both Connecticut and New Jersey. In describing its delineation of metropolitan statistical areas, the Office of Management and Budget stated in June 1983: "The general concept underlying these definitions is that of a geographic area consisting of a large population nucleus together with adjacent communities having a high degree of economic and social integration with that nucleus."⁶³ The Connecticut Act,⁶⁴ which permits a bank holding company in Boston to acquire a bank in the state, but which prohibits a bank holding company from New York City, where thousands of the state's residents work, to take similar action clearly does not benefit a sizeable segment of Connecticut's population.

In summary, regional affinity defined by political (in this case, state) boundaries simply provides no basis for constructing a banking region.

V. PUBLIC POLICY CONSIDERATIONS DISFAVORING REGIONAL ARRANGEMENTS

As in the case of so-called regional affinity, it is difficult to reach conclusions about the public interest without some frame of reference. Perhaps the most logical approach is to consider the reasons why banking legislation is enacted and regulations are established, and to consider how these factors are affected by the regional interstate acquisitions. While people might disagree about specific items in any list of such factors, the Carter Administration's report on interstate banking provides a fairly comprehensive set.⁶⁵ That report cites five public policy issues

62. REPORT OF THE COMMISSION ON MONEY AND CREDIT, MONEY AND CREDIT 166 (1961).

63. OFFICE OF INFORMATIONAL REGULATORY AFFAIRS, OFFICE OF MANAGEMENT AND BUDGET, METROPOLITAN STATISTICAL AREAS, 1983 (June 27, 1983).

64. See *supra* note 8.

65. REPORT OF THE PRESIDENT, DEP'T OF THE TREAS., GEOGRAPHICAL RESTRICTIONS ON COMMERCIAL BANKING IN THE UNITED STATES 12-17 (Jan. 1981). Apart from the reference to the dual banking system, a fairly similar list appears in Stanford Law Professor Ken-

raised by interstate banking restrictions:

- Competition and concentration
- Service to local communities
- Viability of small banks
- Safety and stability of the banking system
- The dual banking system

Each of these factors is discussed briefly below. Admittedly, great care must be taken in interpreting the results of structure-performance studies, and we do not necessarily subscribe to the methodologies or findings of all of the studies cited.

A. Competition and Concentration

Competition cannot be measured directly. One must decide what is meant by competition and how it will be quantified for comparative purposes, and one must delineate relevant product and geographic markets in order to develop measures of concentration. As a result, individuals may disagree about the fine points of a specific measure, test or finding. But, two findings that are quite consistent in the available research are: (1) freer entry enhances competition; and (2) concentration levels have not risen significantly despite the major changes that have taken place in banking structure in recent years.⁶⁶

Attorney General William French Smith, in commenting upon some people's fears of the competitive effects of large banks or bank holding companies, observed:

There are, however, about 14,000 banks in the United States. Neither market concentration nor aggregate concentration is a serious prospect. As for cartels or mergers, the antitrust laws themselves are sufficient to prevent any anticompetitive market concentration from these sources without artificial regulatory barriers.⁶⁷

neth Scott's paper prepared for the FDIC in its 1980 study of state and federal regulation of commercial banks. Scott, *Interrelationships Between Federal and State Bank Regulatory Statutes*, in LEONARD LAPIDUS, STATE AND FEDERAL REGULATION OF COMMERCIAL BANKS 101, 101 (1980).

66. See, e.g., Savage & Rhoades, *The Effect of Branch Banking in Pricing, Profits and Efficiency of Unit Banks*, in PROCEEDINGS OF A CONFERENCE ON BANK STRUCTURE AND COMPETITION 187, 206 (May 3-4, 1979) (Federal Reserve Bank of Chicago); Savage, *Developments in Banking Structure, 1970-81*, 68 Fed. Res. Bull. 77, 82 (1982); S. RHOADES, BANKING STRUCTURE AND PERFORMANCE AT THE STATE LEVEL DURING THE 1970S, STAFF STUDIES III 7 (1981) (Federal Reserve Board).

67. *Attorney General Hits Interstate Banking Restrictions as Anticompetitive*, AM. BANKER, Apr. 8, 1982, at 4, 8.

Similarly, William F. Baxter, Former Assistant Attorney General, Antitrust Division of the United States Department of Justice, has stated:

In my view, the important benefits to be gained from the potential for increased competition if geographic restrictions are eliminated appear clearly to outweigh any dangers of increased concentration. Furthermore, the prevention of undesirable levels of concentration can and should be addressed through the antitrust laws, not through blanket prohibitions on interstate banking.⁶⁸

Like sentiments have been noted over the past decade by officials of the Justice Department—Republican and Democrat alike.

B. *Service to Local Communities*

Numerous studies have been conducted of the lending performance of the bank affiliates of bank holding companies. One of the most detailed reviews of the results of these studies is found in a 1976 compendium of banking issues compiled for the United States Senate.⁶⁹ Following a careful examination of the findings of the research in this area, two contributors to the compendium concluded:

Virtually every study of lending by unit, branch, and multi-bank holding company banks concludes that overall branch banks and holding company affiliates have higher loan to deposit (asset) ratios. Furthermore, there is no evidence that either branches or holding companies *per se* discriminate against rural markets or small borrowers.⁷⁰

Essentially, the same conclusion was reached in a detailed study of the bank holding company movement prepared by the Federal Reserve Board in September 1978. The Federal Reserve Monograph noted: "The finding that subsidiaries invest a higher proportion of their assets in loans indicates that bank holding companies more than likely extend more credit to their local communities."⁷¹ Also, a paper prepared in 1976 by the two Federal Reserve Board researchers who were most fa-

68. *Geographic Restrictions of Bank Expansion: Hearings Before the Comm. on Banking, Housing and Urban Affairs, 98th Cong., 1st Sess. 411, 414 (1983)* (statement of William F. Baxter, Assistant Attorney General, Antitrust Division).

69. *Id.*

70. Davis & Fischer, *The Impact of Multi-office Banking on the Availability of Credit in Smaller Communities*, in SUBCOMM. ON FINANCIAL INSTITUTIONS OF THE COMM. ON BANKING, HOUSING, AND URBAN AFFAIRS, 94TH CONG., 2D SESS., COMPENDIUM OF ISSUES RELATING TO BRANCHING BY FINANCIAL INSTITUTIONS 155, 181 (Comm. Print 1976).

71. THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *THE BANK HOLDING COMPANY MOVEMENT TO 1978: A COMPENDIUM* 99 (Sept. 1978).

miliar with the inner workings and performance of bank holding companies concluded: "Studies of [bank holding companies] have shown *conclusively*, however, that their banks tend to make more credit available to the *local* community than do comparable independent banks."⁷² They went on to note:

Over all, the evidence suggests that the primary benefit of [bank holding company] entry into a community hinges on the more aggressive lending policies of BHC banks. This can be an important benefit because it means that individuals and businesses in the community will be able to obtain more bank credit than they would if BHC's were not present.⁷³

And finally, research at the Federal Reserve Bank of Atlanta in 1983, which examined the existing evidence in this area concluded: "The availability of credit to locally limited consumers and businesses generally is increased, and no evidence suggests that bank holding companies or branch banks redirect funds from less developed to more developed markets."⁷⁴

Many of the proponents of legislation to restrict entry by larger organizations express a special concern about a potential flow of local funds into international loans and investments. While the market studies cited did not differentiate between foreign and domestic loans, it would seem fair to assume that the same conclusions hold because funds in general were not being drawn out of local communities whatever the end use of such funds may have seen. More importantly, however, critics of larger banking organizations often overlook the fact that funds are received from overseas customers and obtained in international markets. While we would not wish to press this point based on the limited information available and concede that great care must be taken in the interpretation of all structure-performance studies, it does seem apparent that arguments against the expansion of large banking institutions because of their involvement in lending abroad are more emotional than factual.

The real issue is whether large bank holding companies are, or would be, good corporate citizens, meeting their responsibilities in all of the communities they serve. Existing research based on the experience of the past offers strong positive evidence that, on balance, the bank subsidiaries of bank holding companies would more than meet this test. There

72. Lawrence & Talley, *An Assessment of Bank Holding Companies*, 62 Fed. Res. Bull. 15, 17 (1976) (emphasis added).

73. *Id.* at 17.

74. Eisenbeis, *Regional Forces for Interstate Banking*, ECON. REV., May 1983, 24, 30 (Federal Reserve Bank of Atlanta).

is certainly no reason to expect that they would be less responsive to local needs than would their competitors.

C. *The Viability of Small Banks*

With the changing structure of the American financial system, many banks are faced with direct competition from much larger organizations. It is possible in this environment for small commercial banks not only to survive but to prosper.

This question was considered separately by several researchers who prepared papers for a special issue on interstate banking published by the Federal Reserve Bank of Atlanta in May 1983. The findings were consistently positive. To quote Robert Eisenbeis of the University of North Carolina, "[n]otwithstanding the fears of smaller banking organizations, branching or holding company expansion appears to pose no threat to the viability of small banks."⁷⁵

The ability of small banks and/or bank holding companies to compete with much larger organizations is quite apparent from market share research. A study of New York State, for example, found "minimal impact from large New York City banks' entry into upper New York state after branching and bank holding restrictions were removed. The large New York City banks' market penetration was modest and their competitors' performance did not suffer."⁷⁶

If substantial economies of scale (producing increasing amounts of a given quality of service at a lower unit cost) or scope (synergy in producing a variety of products) existed, perhaps the above findings might have been somewhat different. In the banking area, however, research has not uncovered substantial economies of scale beyond relatively small banks (say \$50 million to \$75 million in deposits).⁷⁷ However, there is some indication in the literature on economies of scope that while the influx of very large banks into a market may not cause competitive problems for small banks, such influx can be of competitive significance to larger

75. *Id.* For a summary of other studies reaching similar conclusions, see Rhoades & Savage, *Can Small Banks Compete?*, 164 BANKERS MAG., Jan.-Feb., 1981, 59, 60.

76. King, *The Impact of Local Entry by Large Bank Holding Companies*, ECON. REV., Nov. 1982, 41, 43 (Federal Reserve Bank of Atlanta). Also, on the New York experience see similar conclusions in J. HEIMANN, REMARKS BEFORE THE ASSOCIATION FOR MODERN BANKING IN ILLINOIS (Sept. 14, 1978); Kunreuther, *Banking Structure in New York State: Progress and Prospects*, MONTHLY REV., Apr. 1976, 107, 114 (Federal Reserve Bank of New York).

77. King, *Interstate Expansion and Bank Costs*, ECON. REV., May 1983, 40, 42 (Federal Reserve Bank of Atlanta). See also *Special Issue: Interstate Banking*, ECON. REV., May 1983 (Federal Reserve Bank of Atlanta).

banks that are already in the market—say those with more than \$1 billion in deposits. In any event, there seems little doubt that most small banking institutions can compete quite successfully with large banking organizations.

D. Safety and Stability of the Banking System

One of the basic factors underlying the establishment of multi-bank holding companies in the late 1920's and early 1930's was the financial strength they could bring to areas suffering large numbers of bank failures. Companies such as Northwest Bancorporation, First Bank System and Transamerica Corporation brought safety and stability to large numbers of communities. All three of these organizations have long-established interstate banking operations with many of their bank subsidiaries acquired directly as a result of efforts to provide banking service where it would otherwise have been lost.

Risk is extremely difficult to quantify when one considers the operations of a banking organization. Risks may seem to be increased in terms of one measure, yet reduced in terms of another. Nevertheless, at least one study tried to assess the relationship between multi-office banking and the safety and soundness of commercial banks.⁷⁸ The research found "[m]ulti-office banking authority and organizational structure did not appear to be contributing factors to the number or size of banks closed during the 1960's and 1970's."⁷⁹ These findings are important since the study considered not only the multi-office banks themselves but their possible impact on other banks in the state. The findings relating to this question, however, are extremely limited. This was pointed out in a 1982 Federal Reserve study which warned: "There is no direct empirical evidence or good indirect evidence showing a systematic relationship between a bank's size and its ability to control its credit risk position."⁸⁰

Nonetheless, these findings have little relevance in terms of regional interstate compacts. The issue is not whether states will have sizeable interstate bank holding companies operating within their borders—they do under present law. Rather, the question is whether the safety and stability of any state's banking system would be negatively affected if it allowed interstate bank holding companies to own banks within its borders if the holding companies also owned bank subsidiaries outside of its

78. Lane & McCall, *Multi-Office Banking and the Safety and Soundness of Commercial Banks*, 11 J. BANK RESEARCH 87 (1980).

79. *Id.* at 89.

80. Schweitzer & Whitehead, *Bank Size and Risk: A Note on the Evidence*, ECON. REV., Nov. 1982, 32, 33 (Federal Reserve Bank of Atlanta).

self-defined regions. Empirical research tells us nothing about this issue, but logic and experience lead to the conclusion that the result is not likely to be negative. Rather, risk could well be reduced through the additional diversification.

E. Dual Banking

Stripped of its emotional baggage, the dual banking concept is simply that banks may be chartered by either the federal or state government, and that once chartered they will operate subject to the banking law of the chartering government and be subject to supervision by agencies of the chartering government. The system is not of of water-tight compartments. For example, state chartered banks may be, and generally are, subject to certain federal laws and supervision by federal agencies. Nothing in a typical regional compact would enhance or diminish the basic elements of the dual banking system. However, such compacts may infringe on federal supremacy with respect to the monetary power of government.

F. Summary of Public Policy Considerations

An analysis of the five public policy criteria noted above indicates that regional compacts do not serve appropriate regulatory objectives. These considerations are summarized below:

1. Regional interstate compacts restrict entry, even though freer entry enhances competition. There is a strong possibility that, by limiting entry, concentration in relevant markets will be higher than it would have been if entry by companies outside of the compacting states were permitted. In any event, concern over concentration is more appropriately addressed through antitrust laws.
2. There is nothing to suggest that large bank holding companies will provide poorer quality services to the community. To the contrary, studies show bank holding companies increase the availability of credit locally, not decrease it. Criticisms based upon international lending activities of banks which are supposedly drawing needed funds from the small communities they serve simply do not square with the facts. The critics particularly ignore the substantial amount of funds obtained from overseas sources.
3. Small banks can and do prosper in the face of competition from large banks and bank holding companies. There are nu-

merous illustrations of local banks competing successfully with some of the largest banking organizations in this country.

4. There is no reason to believe that the safety and stability of banking in any state would be negatively affected by permitting companies with principal offices or domestic bank affiliates outside the state to acquire banks in the state.

5. Dual banking, in its strictest sense, is neither strengthened nor weakened by regional interstate compacts.

VI. CONCLUSION

Law and economics are not strangers to each other, but the issue posed by regional interstate banking compacts offers one of the more fascinating illustrations of the interplay between the two disciplines. For in this instance, the resolution of an important but essentially mundane economic problem raises constitutional questions that, among other things, go to the very heart of federal sovereignty and to the economic issues with which the drafters of the Constitution wrestled some two centuries ago. Meanwhile, practitioners of the two disciplines are faced with conflicting and unappetizing choices.

For economists, who have long chafed at the decision by the federal government to constrain banking markets to individual states, even a partial dismemberment of such artificial (to an economist) barriers is viewed as a step forward. The hope is that state compacts, even if devised just in the interest of a handful of banking organizations, are but a transitional stage in the evolution of a more rational market structure. However, regional boundaries defined by the states are no less artificial than state boundaries, and the states have no particular incentive or interest in facilitating the development of banking markets that serve the national, as opposed to the states', interest.

For lawmakers, the action by the states in devising regional interstate compacts, with exclusionary provisions directed at states with giant banking organizations, soothes the traditional concerns of legislators with excessive concentration of banking power. Perhaps of more practical significance, leaving the initiative to the states means that legislators can avoid the vexing, emotion-laden issue of interstate banking. It is tempting to act as though the federal government had washed its hands of the issue in 1927 with the McFadden Act and, again, in 1956 with the Bank Holding Company Act. The problem is that the states thus far have served mainly as surrogates for the federal government in its sovereign exercise of the money process, and now the surrogates are in the process of taking (or recapturing) the power itself.

It is probably only within the framework of the Constitution that this complex set of problems can be resolved, that the debates in Philadelphia in 1787 take on fresh meaning, and that the views on banking of an Alexander Hamilton or a Thomas Jefferson once again have current relevance. The authors of this Article believe that the Supreme Court acted wisely in agreeing to review *Northeast Bancorp, Inc. v. Board of Governors*. We hope that the resolution is one that provides for a federal solution that will serve national, rather than parochial, interests in assuring a sound, competitive, banking system.