In our dual banking system, state- and federally chartered banks currently operate in each of the 50 states. The dual banking system would be largely unaffected if interstate banking occurred through repeal of the Douglas Amendment. States would continue to regulate state-chartered interstate bank subsidiaries, and federal regulators would supervise those with federal charters. The repeal of the McFadden Act, however, to permit interstate branching would probably create some formidable problems. For example, jurisdiction over interstate branches of state-chartered banks would have to be allocated, and differences in state regulatory policies toward state-chartered banks would have to be resolved.

Conclusion
A growing number of states permit interstate banking, a trend that is pressuring federal legislators to relax interstate banking barriers. Evidence suggests that removing these barriers would encourage beneficial competition among banks. However, it is doubtful whether current antitrust laws are adequate to prevent the possible negative effects of geographically unrestricted banking. If antitrust laws were teamed with federal guidelines limiting the size of acquisitions, the adverse effects of higher concentration levels could be minimized, and consumers could benefit from the removal of interstate banking barriers.

Banking without Interstate Barriers
by Thomas M. Buynak, Gerald H. Anderson, and James J. Balazsy, Jr.

In today's deregulated banking environment, more and more states are considering loosening their interstate banking restrictions. Ohio, Michigan, and Florida are three of about fifteen states currently considering interstate banking legislation. If such legislation were enacted, these states would join 15 other states that already allow some form of interstate banking. Most of the interstate banking laws are very restrictive as to who can enter and the powers of the entrants. States with the least restrictive laws include Alaska and Maine, which allow interstate banking with any state; New York, which allows interstate banking with any state that permits reciprocal entry; and Massachusetts, Connecticut, and Rhode Island, which allow banks from reciprocating states in New England to expand interstate and bar banks from entering from outside the region.1

According to interstate banking opponents, removing barriers to interstate banking might bring on the consolidation of the banking industry into a few large banks. An example of such concentration is Canada's banking structure, in which there are only 11 banks, each controlling on average $25 billion in assets. However, advocates of interstate banking contend that geographic banking restrictions are anachronistic in today's financial environment. Interstate banking barriers are being rendered ineffective by technological advances such as electronic funds transfer. Banks are also placed at a disadvantage as they increasingly compete with nonbanking firms, such as Merrill Lynch, Prudential-Bache, and Sears, that market financial services through nationwide networks.

De facto Interstate Banking
Despite legal restraints on interstate banking, banking organizations and their subsidiaries have established extensive interstate networks in the past 10 years. In fact, except for taking in retail deposits, some banks perform virtually all of their banking functions on an interstate basis. In a 1982 study profiling interstate activities, banking organizations were found to control over $500 interstate banking offices, consisting primarily of loan production offices for commercial businesses, Edge Act offices for international banking activities, and nonbanking subsidiaries of multibank holding companies. Interstate nonbanking subsidiaries of multibank holding companies numbered 5,000 and engaged in activities such as consumer and commercial finance, mortgage banking, leasing, loan servicing, and trust services. Currently, the nonbanking activity that is being aggressively pursued by larger banks is the acquisition of interstate industrial banks. An industrial bank is a state-chartered institution that can accept deposits and originate loans, but cannot offer checking accounts. Interstate acquisitions of financially weak banks and thrifts are also eroding the barriers to interstate banking. An example of this is Citicorp's recent acquisitions of sizable thrifts in Chicago, Miami, and San Francisco, authorized by the Garn-St Germain Act. Such acquisitions in effect are back doors to interstate banking.

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1. The state legislatures of Georgia, Utah, and Kentucky have recently approved interstate banking bills. After two years, Rhode Island's statute will convert to national reciprocity.

Bank Control: Statement of Policy on Nonvoting Preferred Stock that would be purchased by these banks are purchasing significantly for interstate banking. However, they may also accept deposits for out-of-state customers and transfer funds between accounts in a manner that would minimize federal supervision.

Public Policy Issues
A report prepared by the Carter administration examined whether the public would benefit if interstate banking barriers were lifted. In January 1981, the Carter administration explored several strategies, including (1) relaxing current regulations on the entry of ATMs, (2) exempting banks’ wholesale services from interstate restrictions, (3) repealing the McFadden Amendment, and (4) repealing the Bank Holding Company Act of 1956 (BHCA). The McFadden Amendment allowed banks to enter interstate business only if state-chartered banks in the same state could do so, and the interstate boundary was effectively established as the limit for bank branching.

Prior to the passage of the BHCA, banks could acquire out-of-state banks through multibank holding companies. However, Section 20(b) of the BHCA, known as the Douglas Amendment, prohibited interstate bank acquisitions unless the state where the acquired bank was located specifically permitted such entry. Until 1975, no state permitted such entry.

Through an interstate ATM link-up, an individual can obtain cash, check account balances, and transfer funds between accounts in multiple states. A few very large banks are also positioning for interstate banking with de novo offices. These banks are purchasing significant equity interests in out-of-state banks by buying warrants for common stock at a discount. The public will benefit if non-voting preferred stock that would convert to voting stock if geographic banking barriers were lifted.

Concentration and Competition
Perhaps the most controversial issue in the interstate banking debate is the effect of fewer restrictions on competition among banks and the concentration of financial resources. An issue is whether interstate banking would foster better services, lower profits, and less bank concentration.

In a national level, interstate banking would increase the concentration of commercial banking resources, reversing a trend toward less concentration. If interstate banking were allowed, the nation’s largest banks would be especially aggressive in entering new interstate markets; banks with strong market positions in metropolitan areas would undoubtedly be prime targets for acquisition. Regional and state banks would be excluded from such entry. The concentration resulted from de novo entry into rural and small metropolitan markets. It would thus make sense to limit the interstate entry on a de novo basis. However, few banks would probably heed such encouragement since de novo entry rarely achieves effective market penetration.

Even if higher concentration levels resulted from lifting interstate barriers, the threat of potential entry would help ensure competitive behavior. To illustrate: although an aggressive bank might obtain a significant share of a market’s deposits, it’s potential entry would help keep the market competitively priced. Otherwise, the bank would be inviting additional competitors into the market. Thus, it is not clear that high entry and higher concentration levels are combined, the question becomes whether the positive effects of potential entry outweigh the negative effects of concentration.

The linked oligopoly theory has been applied to the banking industry to analyze the competitive effects of multistate banking. According to this theory, as multi-state banks grow, they will meet each other in geographically dispersed markets, less competitive selection will occur, a firm’s aggressive actions will be more easily foreclosed, and the possibility of bank holding companies will increase. Large banks are dominant. In California, for example, banks with assets exceeding $100 million accounted for only 25 percent of small banks in 1977, but controlled 97 percent of statewide banking assets. Yet, California’s banks with assets exceeding $100 million were able to earn, on average, a return on assets about the same as the state’s larger banks. In intrastate branching was authorized in New York State in the mid-1970s, large banks headquartered in New York City were permitted to penetrate banking markets in upper New York State that were controlled primarily by small banks. In fact, many of the large banks’ newly opened offices closed because of unprofitable operations or ineffective market penetration. These studies indicate that small banks can survive and compete with larger banks in a geography that is unrestricted by restrictions.

Evidence that large banks have no cost advantages over smaller banks underscores the ability of small banks to thrive without geographic banking restrictions. In fact, studies on scale economies in banking suggest that large banks’ market size is relatively small, with deposits between $10 million and $25 million. This is consistent with studies of small banks in large communities in states that authorize interstate banking services if interstate banking restrictions were eased.

Interstate banking would reduce the number of banks. Small banks in particular contend that they would be overwhelmed by large banks. A recent study examining the operations of small banks in states that allow interstate expansion found that interstate expansion, either via branching or bank holding companies, would expose these banks to increased competition, and that large banks are dominant. In California, for example, banks with assets exceeding $100 million accounted for only 25 percent of small banks in 1977, but controlled 97 percent of statewide banking assets. Yet, California’s banks with assets exceeding $100 million were able to earn, on average, a return on assets about the same as the state’s larger banks. In intrastate branching was authorized in New York State in the mid-1970s, large banks headquartered in New York City were permitted to penetrate banking markets in upper New York State that were controlled primarily by small banks. In fact, many of the large banks’ newly opened offices closed because of unprofitable operations or ineffective market penetration. These studies indicate that small banks can survive and compete with larger banks in a geography that is unrestricted by restrictions.

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