

BUSINESS REVIEW

Federal Reserve Bank of Philadelphia

ISSN 0007-7011

JULY-AUGUST 1979

AD DO NOT
Give away ✓

LIBRARY
AUG 28 1979
FEDERAL RESERVE BANK OF PHILADELPHIA

Mass Transit Subsidies



The MCFadden Act

&
Unemployment
Insurance Programs:
A New Look
for the Eighties?

JULY/AUGUST 1979

**THE MCFADDEN ACT:
IS CHANGE IN THE MAKING?**

Commentary by Edward G. Boehne

**MASS TRANSIT SUBSIDIES:
ARE THERE BETTER OPTIONS?**

John Gruenstein

. . . Mass transit subsidies may not produce their intended results without direct action to cut auto use.

**UNEMPLOYMENT INSURANCE
PROGRAMS:
A NEW LOOK FOR THE EIGHTIES?**

Robert J. Rossana

. . . Recent studies suggest that current unemployment subsidies to both workers and employers may retard the achievement of full-employment goals.

**BUSINESS
REVIEW**

Federal Reserve Bank of Philadelphia
100 North Sixth Street
(on Independence Mall)
Philadelphia, Pennsylvania 19106

The BUSINESS REVIEW is published by the Department of Research every other month. It is edited by John J. Mulhern, and artwork is directed by Ronald B. Williams. The REVIEW is available without charge.

Please send subscription orders, changes of address, and requests for additional copies to the Department of Public Services at the above address or telephone (215) 574-6115. Editorial communications should be sent to the Department of Research at the same address, or telephone (215) 574-6426.

* * * * *

The Federal Reserve Bank of Philadelphia is part of the Federal Reserve System—a System

which includes twelve regional banks located around the nation as well as the Board of Governors in Washington. The Federal Reserve System was established by Congress in 1913 primarily to manage the nation's monetary affairs. Supporting functions include clearing checks, providing coin and currency to the banking system, acting as banker for the Federal government, supervising commercial banks, and enforcing consumer credit protection laws. In keeping with the Federal Reserve Act, the System is an agency of the Congress, independent administratively of the Executive Branch, and insulated from partisan political pressures. The Federal Reserve is self supporting and regularly makes payments to the United States Treasury from its operating surpluses.

The McFadden Act: Is Change in the Making?

*By Edward G. Boehne, Senior Vice President,
Federal Reserve Bank of Philadelphia*

A new wave of technology and competitive pressure has put the half-century-old McFadden Act on the defensive. Congress has asked for review of this statute, which says that national banks must comply with state branching standards, by year's end. And a recent court decision is prompting a broader legislative review of how thrifts and banks compete with each other.

Whether the McFadden Act is modified or left unchanged, the inevitable result of competition will be to alter the structure of banking for years to come. For underlying current consideration of the McFadden Act are basic forces which, history tells us, cannot be restrained by laws or artificial barriers.

TECHNOLOGY AND COMPETITION I

Single-office banking dominated the American scene until the 1920s. Then came the automobile. As cities expanded and traffic

congestion in downtown areas increased, bankers found it more difficult to reach their customers. Moreover, the middle class was becoming affluent enough to make household accounts profitable. Innovative bankers began to search for ways to capitalize on the growing potential for profits through branching, especially citywide branching.

Federal law was construed to mean that national banks were limited to a single office. But state-chartered banks in some states operated under more liberal branching statutes. Thus pro-branching forces found flexibility by playing state regulations off against Federal regulations. The crack in the regulatory dike grew larger, much to the dismay of politically powerful unit bankers, as national banks converted to state charters.

The McFadden Act was passed in 1927 to restore some semblance of competitive equality to national and state-chartered banks in the new era of the automobile. Its

key provision allowed national banks to establish branches within the limits of the city or town where it was headquartered if state law permitted such branches to state banks. The Banking Act of 1933 liberalized this intracity limitation by allowing national banks to establish branches over the same geographical areas as those specified by the states for state-chartered banks, but interstate branching continued to be prohibited. Basically, there have been no further changes in Federal branching legislation since the 1930s.

TECHNOLOGY AND COMPETITION II

History is repeating itself, but on a grander scale. Instead of the automobile broadening urban markets, it is an explosion of communication know-how that is broadening national and international markets. These broadened markets, now as before, are opening up new profit opportunities and placing intense pressures on established competitive relationships, as entrepreneurs inside and outside the traditional financial sector move imaginatively and quickly to find flexibility in a regulated environment.

Commercial banks have taken a number of initiatives. If hindered by the courts or one regulator, they often move to another regulator or to the state or Federal legislature. Bank holding companies, loan production offices, Edge Act subsidiaries, and chain banks have all exemplified this effort on the part of commercial banks to deal flexibly with restrictions on branching. Bank credit cards, too, have enabled banks to extend their markets beyond branching limits. And international branching has increased opportunities for foreign banks to reach new customers here and for American bankers to reach new customers abroad.

Moreover, and particularly disturbing to commercial bankers, there is increasing competition from those not bound by bankers' rules. Nonbank financial institutions, such as thrift institutions, mutual funds, and insurance companies, now have more assets

than commercial banks. Commercial bankers in restrictive branching states fear further erosion of their market shares if nationally chartered thrifts are allowed to branch statewide or across state lines within metropolitan areas. Such proposals are before the Federal Home Loan Bank Board. Congress, too, will soon be debating the competitive relationship of thrifts to banks in light of a court decision last spring which restricts the latitude of regulators to grant additional powers to financial institutions.*

The challenge from nonfinancial competitors is even more formidable. Two firms, Sears and Montgomery Ward, have a greater dollar amount of consumer credit than do the 400 commercial banks in the entire Third Federal Reserve District. Of the 600 million credit cards outstanding nationally, 85 percent have been issued by companies other than banks. These companies are able to generate assets and open facilities without regard to the geographical restrictions faced by financial institutions. Many bankers feel that they are competing with one hand tied behind their backs.

WHAT NEXT?

Although the competitive stage is bigger now and the technology is more complex, today's policy question is fundamentally the same as that faced by the framers of the McFadden Act: how to fashion a regulatory environment that balances the new competitive and technological realities against the traditions of maintaining the dual banking system and safeguarding small banks. To ignore competitive and technological changes would stifle innovation and make it more

* The U.S. Court of Appeals in Washington, D.C. ruled in April that the National Credit Union Administration, the Federal Home Loan Bank Board, and the Federal Reserve Board lacked the power, respectively, to authorize share drafts for credit unions, electronic terminals for savings and loan associations, and automatic transfers servicing for banks. The court stayed its order until January 1, 1980 to provide Congress time to respond.

difficult for banks to serve expanding markets efficiently; to ignore traditional concerns would provoke an unproductive clash over established values.

The McFadden Act emerged slowly, and future change will likely emerge slowly as well. Some possibilities include: permitting interstate branching within metropolitan areas, perhaps limited initially to EFT terminals; permitting out-of-state bank holding companies to acquire failing banks; and permitting out-of-state banks to establish branches on a reciprocity basis. Further into the future, the possibilities include: statewide branching in all states and perhaps interstate branching outside metropolitan areas. Well down the road, the industry could develop a three-tiered structure, with several dozen multinational giants in the first tier, several hundred regional banks in the second, and a still larger number of small banks serving local markets in the third.

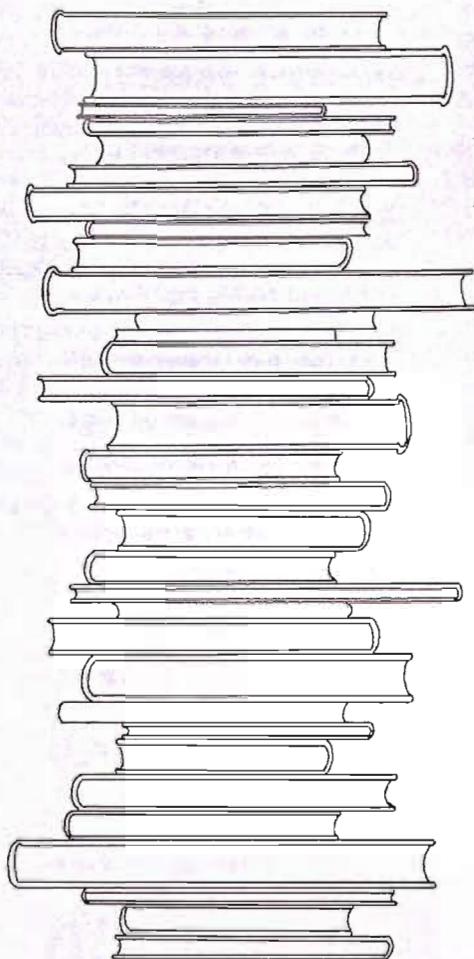
Well managed community banks have demonstrated that they can successfully

compete with branches of larger banks in the same way that specialty shops compete with department stores and quickstop grocery stores compete with supermarkets. Regulators can help foster a favorable climate for community banks by limiting the share of deposits large banks can have. For example, New Jersey, where statewide branching is legal, permits an individual bank to hold no more than 20 percent of statewide deposits.

Emotions run high when the branching issue surfaces. It was so during the debate that led to the McFadden Act in the 1920s; it will be so as changes in the McFadden Act are debated in the 1980s. If the past is any guide to the future, the new advance of technology and heightened competition will lead, as day follows night, to a further loosening of geographical limits on banking activity. The challenge is to facilitate adaptations that help bankers better serve the financial needs of their customers while maintaining sufficient continuity with traditional arrangements to avoid undue disruptions.

THE FED IN PRINT

1974 - 1978



Now Available . . .

THE FED IN PRINT 1974-1978. A Subject Index to Federal Reserve Periodicals.

This updated guide indexes articles that have appeared in the *Federal Reserve Bulletin* and in the reviews and other periodicals of the System banks. Single copies are available upon request. Write FED IN PRINT, Department of Public Services, Federal Reserve Bank of Philadelphia, 100 North Sixth Street, Philadelphia, Pennsylvania 19106.