

RESTRUCTURING
BANKING

& FINANCIAL
SERVICES
IN
AMERICA

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The Future Financial Structure: Fears and Policies

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The structure of the U.S. financial system is undergoing tremendous change. Although this change is only in its early stages, its direction seems clear: the elimination of geographic and product constraints that in the past have prevented open and unfettered competition among all financial institutions.

Many view with alarm the prospect of unrestrained competition in financial markets. They fear that, rather than increasing the permanent state of competition, increased competitive rivalry will ultimately lead to a less competitive and efficient financial structure. They argue that after the structural turmoil plays itself out, the result will be a highly concentrated financial structure, in which only very large, highly diversified, and internationally integrated institutions can survive. With fewer and larger institutions, it is argued, competition will give way to oligopolistic markets, leaving lenders, borrowers, and consumers of financial services worse off than they are now.

This paper describes and analyzes this concern as well as others stemming from the feared structural changes. In particular, I examine the allegations that a financial structure of the kind that I envision, one with fewer and larger financial institutions, will be less competitive, will pose greater risks to the soundness of the financial system, will result in unfair competitive practices, will adversely affect the allocation of credit, or will confer undue political power on large financial institutions. In addition, I discuss regulatory and antitrust laws currently applicable to financial institutions and make recommendations on future policies on competition.

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The fear of large financial institutions, and of financial concentration, while not unique to the United States, is deeply embedded in this country. Both our political and our economic heritages extol the virtues of independence, smallness, and atomistically competitive markets, particularly with respect to banks. It is not surprising, therefore, that many are concerned that current developments are driving us away from these tested ideals.

The structural changes now under way stem directly from advances in information and data processing technologies, which make it attractive for financial institutions to operate as multiproduct service centers over large geographical areas. The amount of institutional capital needed to participate in many markets today also makes large size desirable. In addition, while this notion is difficult to verify, economies of both scale and scope appear to have increased in recent years and are likely to increase further in the future.

At the same time the regulatory restrictions that in the past have fostered and maintained an artificial (or non-market-determined) financial structure are giving way. Thousands of small, inefficient banks and thrift institutions have been able to survive only because of prohibitions on the ability of banks to branch both intrastate and interstate. Without these prohibitions, many institutions would either disappear or be absorbed by larger institutions (as branch offices). Similarly, product restrictions have kept alive many specialized financial institutions that otherwise would have been driven out. It is difficult to see a unique role in the future for the thousands of specialized consumer and mortgage lending institutions that we now have. I expect many of these to disappear as independent entities, although there will probably always be a place for specialized firms that offer superior service to a selected clientele. It is not possible to forecast just how many financial institutions will remain, how big they will be, what products they will offer, and what the size distribution of these firms will be. I have no doubt, however, that there will be fewer institutions in the future. It is also clear that with the globalization of financial markets U.S. financial institutions will have to compete directly with very large foreign institutions. (See, for example, appendix A, table A-9.) Thus, although it is too early to make a firm prediction about how our financial structure will look in the year 2000, it seems likely that we will have fewer and larger institutions.

Without knowing the precise contours of the future financial structure, we cannot say with certainty which of the fears about "bigness" need to be addressed. The future financial structure will depend to some extent upon which of the current regulations are

eliminated and which are kept. For purposes of this paper, I assume that restrictions on interstate banking (or branching) will be completely eliminated and that financial institutions (including banks) will be able to provide, either directly or indirectly, a full range of financial products and services. In the absence of these restrictions market forces will be the primary determinant of our financial structure.

These assumptions do not seem unrealistic in view of the changes occurring in bank holding company laws, the erosion of barriers separating banking and commerce, and the increasing openness of states to branching and to interstate banking. By examining the structural implications of this kind of nationwide banking, I analyze what I believe to be the worst fears of those alarmed by recent developments. My objective here is to separate truth from fiction and to elucidate the bases for the concerns generated by the continuing structural evolution.

Regulation versus the Free Market

Even before examining the key arguments in the dispute, we must ask the fundamental question whether (or when) regulation should be used to interfere with the natural and competitive evolution of the financial structure. The wave of consolidation we are witnessing in financial services is clearly motivated by the desire of firms to survive or to strengthen their position for the future. Managers of financial institutions obviously see advantages to size and to the ability to provide a wide range of products over an extended geographical area.

Past studies of bank costs have generally not provided evidence of significant economies of scale in banking, although they do not find evidence of significant diseconomies either. These studies, however, rely on past data and therefore do not reflect recent changes in information and data-processing technologies, which have substantially changed the cost structures of financial institutions. In addition, the studies do not adequately measure the benefits of greater geographical, product, and country diversification and do not capture the financial and fund-raising capabilities of large size, all of which are difficult to capture and measure in a statistical cost analysis.

It is apparent that competition in financial markets is keener now than at any time since the 1920s. The present consolidation hardly seems a threat to the viability of this competition, at least in the near future. Both bank regulators and antitrust authorities have implicitly recognized this fact by challenging very few of the proposed mergers

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between financial institutions. The Department of Justice has also recently liberalized the merger guidelines applicable to banks in recognition of the increased competition in financial markets.

What justification, then, is there for government to intervene to alter or stop the continuing structural evolution? Two arguments come to mind. First, intervention at some point may be justified to prevent the development of monopoly power. Second, and less clear, intervention may be justifiable if large size *by itself* carries with it undesirable features. Although many do not object to large firms in general, they single out large banks as especially worrisome. This paper addresses both concerns: the fear of monopoly power and the contention that large banks (and possibly any large financial institution) should be treated differently from other large firms.

The paper does not attempt to assess the costs of regulation. An extensive literature demonstrates that government intervention (or regulation) is not without cost. With respect to financial markets in particular, the perverse allocation and managerial effects attributable to regulation have been amply shown.¹

A restrictive merger policy, for example, may inadvertently protect inefficient firms from "hostile takeovers" that may enhance efficiency. Past regulation has made it nearly impossible to effect such a takeover of banks and other depository institutions. Thus, in developing an appropriate "competition policy," it is important to balance the potential benefits of such a policy against both the direct and the indirect costs that may accompany this policy. Too often these are overlooked in formulating a regulation to meet a perceived short-run threat.

Consolidation, Concentration, and Monopoly Power

The fear that the current wave of consolidation and bankruptcy will lead to excessive concentration and, as a consequence, to less competitive markets rests in large part upon a misunderstanding of what concentration is and how it affects competition.

Measuring Concentration. The measure of concentration germane to market competition is the degree of concentration in the relevant market—the relevant geographic and product market. Incorrectly measured, or measured for the wrong market, concentration becomes a meaningless concept. In theory, the level of concentration represents the competitive structure of a market—for example, the number and size distribution of competitors.² An essential element in making

concentration a useful measure of competition, however, is to define the relevant market correctly.

Equally important is entry or how we treat the threat of entry into the relevant market, once defined. If entry into (and exit from) the relevant market were costless, even a single ("monopoly") firm would not have monopoly power in that market. If the firm were to raise its prices in an attempt to earn monopoly profits, new competitors would arrive on the scene and undercut its prices, forcing the firm to lower its prices to competitive levels.³ If entry and exit are not costless (or there are entry barriers), concentration becomes more meaningful as a measure of market power. The higher the entry barriers are, the more likely it is that the level of concentration will give an accurate picture of the state of competition.⁴

Thus, for concentration to have any meaning, two essential elements must be present: the relevant market must be defined correctly and barriers to entry into that market must be accurately assessed.

Fear of Increased Concentration. Misunderstanding of these two factors has led to an unwarranted fear that the recent (and threatened) consolidation wave will raise concentration and diminish competition in banking and financial markets. A common mind-set is to view what is happening in financial markets from both a "traditional industry" perspective and a nationwide perspective. As consolidation occurs and the number of financial firms diminishes, it is often assumed that "concentration" in the United States as a whole will increase. A commonly used (but not very enlightening) measure of such concentration is the percentage of total bank deposits held by the ten largest banking organizations. This is now about 17 percent.⁵ Will this figure rise or fall in the future, and should we be concerned?

If the entire country is deemed to be a relevant financial market, two factors need to be recognized. First, a concentration ratio of ten banks holding less than 20 percent of the banking market is a *low* level of concentration, not a high level. It implies vigorous competition, not monopoly. Second, it is not obvious that nationwide concentration will rise as a result of the financial revolution. It has, in fact, fallen since 1953. In addition, as "banking" is redefined, or as nonbanks (such as securities firms) compete more directly with banks, concentration is likely to fall rather than rise. The inclusion of large insurance companies (like Prudential) and securities firms (like Merrill Lynch) in any measure of concentration will reduce concentration.⁶ Large foreign banks and financial institutions also are invading the United States at an unprecedented rate, further diluting

concentration. In 1970, seven of the ten largest banks in the world were U.S. banks. In 1986, only two U.S. banks were among the top ten; five of the ten largest were Japanese.⁷ Further, only one of the next largest fifteen banks is American. Thus, the fear that concentration will increase and that competition will diminish nationally seems both unwarranted and premature.

Another concern is that concentration will rise in local markets, such as in states and cities. Assuming this were to occur, is there reason for concern? Technological and market developments have redefined the boundaries of banking and financial markets. Electronic banking, computer information capabilities, automated tellers, credit cards, asset securitization, and the erosion of legal barriers have made traditional local market definitions old-fashioned. Concentration measured in the context of an irrelevant market is meaningless.

Even if traditional (local) market definitions were considered appropriate, concentration in such markets does not have the significance it once did. In past years local markets were more often than not insulated from outside competition by restrictive branching and holding company laws and by strict product delineations between different kinds of financial institutions. This is no longer the case. Most banking services, or perhaps all, depending upon how one classifies them, are now available at nonbank financial institutions, and most geographical restrictions have been or are being dismantled. In other words, the major entry barriers that used to exist no longer do. Entry into local markets is not the costly affair it once was. Indeed, entry costs in financial markets seem low in comparison with those in other industries. Thus, in the presence of low entry barriers, measures of concentration tell us very little about the state of competition. High concentration could very well be consistent with a high degree of competition because of the real and constant threat of entry.

A simple example may make this even clearer. Let us take banking. Regulatory authorities have in the past defined relevant banking markets quite narrowly. Commercial banks were viewed as unique; they provided a unique product: "commercial banking services." The rationale that underlay this approach was that banks alone provided both demand (or transaction) deposits and business loans. Taken together, these created a unique financial service. Thus, only other commercial banks could be considered competitors. Nonbank financial institutions were irrelevant in an assessment of the effects of a proposed merger between two banks.

The geographical scope of banking was also constrained to local areas. Branching and holding company regulations prevented banks

located outside the local area from coming into the market. Thus, in nonbranching states (and perhaps in states with limited branching), the relevant geographical banking market was commonly defined to be either the local town (or city) or, at most, the county. In "statewide" branching states the market was expanded somewhat.

With banking markets defined in this way potential competitors and potential competition had little role. Only banks were viewed as competitors, and all competing banks were already included in the market. Potential competitors were excluded absolutely by legal barriers. We might say that entry barriers were infinitely high. Under these restrictive entry conditions, the level of concentration in the local market was a meaningful index of the state of competition.

Circumstances have clearly changed. Many financial institutions other than banks offer either transaction (deposit) accounts or business loans or both. Savings institutions, for example, compete actively for transaction balances and sometimes for business loan customers as well. Brokerage firms with their cash management accounts constitute another competitive alternative. Credit and debt cards have replaced the traditional checking account in many transactions. Further, automated teller machines (ATMs) in conjunction with "banking" cards have made it easier for institutions outside a local area to have an effective competitive presence in a given locality, and branching restrictions have been eroded to the point where entry from outside the area is again a matter of economics rather than legal barriers. Finally, in the 1950s, checking accounts constituted from 60 to 70 percent of banks' funds. Today they constitute just a little over 20 percent.

Business loans are also no longer the exclusive province of commercial banks. A remarkable development has been the explosive growth of the commercial paper and the corporate bond markets, both of which are substitutes for commercial bank business loans. Commercial paper issued by nonfinancial businesses and finance companies, for example, has increased from \$4.5 billion in 1960 to almost \$250 billion today. In addition, finance companies have become independent and viable competitors in the business loan market. At one time dependent upon banks for much of their funding, they now rely almost exclusively on securities markets. Foreign banks, and their agencies and branches, have also become aggressive competitors for business loans. From 1970 to 1986 U.S. banks' share of total loans to businesses fell from 81 percent to 65 percent.

In the future nonbank financial firms will probably be able to compete directly with commercial banks in any product line that

banks offer. For example, Merrill Lynch now offers the small businessman a form of interest-bearing checking account combined with a line of credit, investment advice, retirement planning, and insurance. The development of sophisticated and deep securities markets, together with innovative financing arrangements, has made major financial firms (and even nonfinancial firms) potential competitors with traditional financial intermediaries such as banks.

Thus, the concept of a banking market as a local community with no competitors other than full-service commercial banks is no longer realistic. Both the relevant product and the relevant geographic markets must be redefined to reflect current market realities, and potential competition must be elevated to a significant role in an analytical assessment of the state of banking competition. Easy generalizations about relevant markets are no longer possible: markets must be defined case by case, based on the facts and circumstances of the case. Finally, concentration ratios, as indexes of the state of competition, must be carefully defined to include all competitors (not only banks) and must be interpreted in the context of entry barriers and potential competitors.

It is not, in any case, clear that concentration correctly measured will rise in local banking and financial markets. No evidence suggests that this has in general happened in the past twenty years.⁸ In addition, it is easy to imagine that, even if we were left with some very large financial institutions in the United States, local markets would still contain more financial institutions in the future than they do now. The "minimum efficient size" of a branch office of a large nationwide institution is almost certainly less than for an independent bank.⁹ A local market of a given size, therefore, could support a larger number of competitors, which are themselves part of larger nationwide institutions.

In summary, the current consolidation movement in financial markets does not foretell a lessening of competition. Although it is certainly true that the total number of banks and other financial institutions operating in the United States will decline, the relevant signs of competition are unlikely to deteriorate. Concentration in *relevant* markets is unlikely to rise and may even fall; and entry barriers will be lower than ever. Further, antitrust laws and other competitive policy guidelines can still be used to maintain a competitive environment. Thus, those who fear that rising concentration will lead to monopolistic financial markets are either focusing on meaningless measures (or concepts) of concentration or are misconstruing the nature of the competitive process now under way in banking and financial markets.

Are Banks Special?

In addition to the fear of increased concentration, there has always been concern that banking in combination with other financial services (or commercial activities) will result in "unfair competition." Banking conglomerates, it is argued, enjoy unfair competitive advantages that can be used to reduce market competition.¹⁰

This argument has two aspects. First, do banks, because of the explicit and implicit guarantees given to their creditors by the government (such as deposit insurance), enjoy competitive advantages over other financial institutions? Can they, for example, raise funds at lower cost? Second, are some bank services (or products) so rare that they enable banks to extend their monopoly power over these products to other products, through, in particular, tying arrangements and predatory pricing strategies?

Federal Guarantees and a Level Playing Field. Federal guarantees cannot be discussed without first specifying the kind of financial structure we assume will exist in the future. My assumption is that the financial firm of the future will conduct a banking business as well as many other financial businesses (securities, insurance, and the like). It will not, however, be a one-way street. If banks enter the securities business, securities firms will presumably be allowed to enter banking. In this scenario, all financial institutions will have equal access to federal guarantees, thus eliminating the issue of unfair competitive advantage.

In the absence of equal access to federal guarantees, an "equal competition" issue may arise, although its definition, measurement, and potential significance are debatable. To begin with, the competitive advantage may be relatively minor.¹¹ Second, institutions that receive federal guarantees (such as deposit insurance) may also have a heavier regulatory burden, which may outweigh any cost advantage associated with such guarantees. Last, while some institutions could be disadvantaged, overall market competition should not suffer. Competitors may be injured, but not competition. New competitors will merely replace old competitors. If, for example, banks enjoyed a cost advantage over securities firms, they would simply replace securities firms. Alternatively, if securities firms enjoyed the advantage, they would supplant banks. Firms would suffer but not competition, since many competitors would remain.

The issue, therefore, is really fairness rather than competition. Defining and constructing a "level playing field" is probably impossible under our existing maze of regulations. As a consequence, a

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fairness argument can be used to justify almost any kind of government intervention. The only sure solution is to adopt a regulatory structure that ensures equal access to all competing institutions, whether they are banks, savings institutions, securities firms, or insurance companies.

Unfair Competitive Practices. It is sometimes argued that banks might use predatory pricing tactics and various tying arrangements to restrain competition in nonbank markets. More specifically, some allege that banks will use the competitive leverage that certain banking products purport to bestow upon them to extend their market power to other products over which they would otherwise have no control. Thus, the argument goes, allowing banks to sell nonbanking products or to combine with nonbank financial institutions would lessen competition in associated nonbanking markets.

This concern stems from a misunderstanding of the conditions under which such tactics could actually reduce competition. A common misconception is that tying arrangements and predatory pricing are always harmful or that they always exert a restraint on competition. This is wrong. Careful analysis demonstrates that only under rather exceptional circumstances will these tactics diminish competition.

Tying arrangements. A tie-in sale is a form of marketing in which a seller insists on selling two distinct products or services as a package. A supermarket, for example, that will sell flour to consumers only if they also buy sugar is engaged in tying.¹²

The fear that banks will use tying as a device to reduce competition in financial service markets has long been embedded in our legislative and regulatory thinking. As early as 1969, when the bank holding company movement was in its early stages, the House Committee on Banking and Currency stated:

Because many large and small businesses, as well as individuals, depend on bank credit for their economic existence, bank subsidiaries of one-bank holding companies are in a position to insist or "strongly suggest" that if the borrower wants continued access to bank credit, it should also use the services of the holding company's other subsidiaries. These services might include insurance, equipment leasing, property management, accounting, computing, investment and travel services, or any other business the holding company might decide to undertake. This would create unfair competition for non-bank related competitors of these subsidiaries and could in the long run substantially reduce or eliminate

competition in many businesses to the detriment of the public interest.¹³

A similar alarm was also sounded by the chairman of the Federal Reserve Board at that time: "Another safeguard that should accompany expansion of bank holding company activities is a prohibition against so-called 'tie-in' arrangements."¹⁴ These warnings ultimately found expression in section 106 of the 1970 Bank Holding Company Act, which expressly prohibits coerced joint sales.¹⁵

The ability of a tying seller to restrain competition—either by reducing the number of competitors in the tied-product market or by raising entry barriers into that market—depends on a number of market factors. First and most important, the tying seller must have sufficient economic power with respect to the tying product to restrain appreciably free competition in the market for the tied product.¹⁶ Without "control or dominance over the tying product," the seller could not use the tying product as "an effectual weapon to pressure buyers into taking the tied item," so that any restraint of trade would be "insignificant."¹⁷

Second, the market circumstances must be such that the monopolistic tying seller can extend his monopoly power to (or acquire additional market power in) the tied-product market. Economic analysis suggests that the ability to do this will depend upon the following: (1) the shape of the monopolist's long-run average cost curve for producing the tied product; (2) the minimum efficient size of plant relative to the size of the market for the tied product; (3) the number of competitors in the tied-product market before the tie-in; and (4) the proportion of the tied-product market that the monopolist can foreclose with a tying arrangement.

To see the importance of these factors, consider the following. Suppose that there are absolutely no economies of scale in producing the tied product (*B*) and that our monopolist (*M*) is able to foreclose the "entire" market by tying *B* to *A* (the tying product). Thus, assume that everyone who buys *B* also buys *A*. If new firms are able to enter the market for *B* at a small volume of sales but with long-run costs similar to those of *M*, *M* can never establish additional monopoly power over *B*. As soon as *M* tries to charge the buyers of *B* a higher price than the combination of *A* and *B* is worth to them, some buyers of *B* will stop purchasing *A* from *M* and look to other sellers for a lower price on *B*, establishing an incentive for firms to enter the market. Since the absence of economies of scale permits entry at a small volume, entry will materialize quickly. Thus, the tying arrangement will not have an adverse welfare effect.

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Even in the absence of economies of scale, however, it is possible that the ability to foreclose the entire market for *B* may result in higher entry barriers. Potential entrants will have to contend with the possibility that *M* may reduce the price of *B* to a point where he can again foreclose the entire market, forcing the new entrants to exit the market. If potential entrants evaluate this risk as high, *M* may be able to sell *B* at a higher price and still not provoke entry. In other words, the entry-forestalling price will be higher than it would be if *M* did not have the capability of foreclosing the entire market. Under these conditions the consumers of *B* will be worse off.

It is clear that the competitive effects of a tie-in sale depend upon the particular conditions that exist in the market at the time. One generalization, however, can be made. If many firms either produce or are able to produce both *A* and *B* and there are low entry barriers into the markets for *A* and *B* when sold jointly (or when tied), no producer can for long earn monopoly rents by tying *A* and *B* together. New entrants will prevent that from occurring. In the emerging financial markets, many institutions are likely to be capable of entering two or more markets simultaneously. Thus it is questionable whether, as a general proposition, tying arrangements will adversely affect competition.

Before the recent evolution in financial markets, the argument that banks might possess significant market power over certain traditional banking products and services, such as business credit, had some basis. Today there are a number of alternatives for these banking products. As a consequence, banks are even less likely today than in the past to have the requisite market power (over the tying product) to implement a destructive tying arrangement.

Predatory pricing. Another concern is that banks might use their (monopoly) profits from certain services to sell other services at "below-cost" prices, thereby driving competitors from the other market and lessening competition. As defined in *Cargill Inc. et al. v. Monfort of Colorado*, predatory pricing is "pricing below an appropriate measure of cost for the purpose of eliminating competitors in the short run and reducing competition in the long run."¹⁸ The fear is that banks will use supracompetitive profits from products for which they allegedly possess monopoly power to cross-subsidize other products, driving competitors from that market and ultimately creating still another monopoly position.

Two factors must be present for this result to occur: first, the "predator" must possess monopoly power in at least some markets; and, second, the "predator" must have a reasonable expectation of

recovering more than its initial losses (from cross-subsidizing another product) in the form of later monopoly profits. Neither of these factors is likely to be present in today's financial markets or in the financial structure I envision in the future. First, banks no longer possess monopoly power over traditional banking products, and competition in all product lines is quite intense. Second, in today's markets (and in the future) monopoly pricing should breed quick entry by new competitors eager to share in the excess profits. A rational, profit-maximizing predator, therefore, could not expect to maintain its monopoly position long enough to recoup its initial losses. Furthermore, its ability to harvest additional profits is even more unlikely. Not surprisingly, commentators agree "that predatory pricing schemes are rarely tried, and even more rarely successful."¹⁹

Thus, predatory pricing should not be viewed as a serious obstacle to the affiliation of banks with other financial institutions or to the proliferation of branching. Although predatory pricing schemes are a possibility, they are unlikely to succeed in lessening competition.

In summary, nothing special about banks or financial institutions makes unfair competitive schemes of greater concern than they are in any other industry or market. To the extent that strategies like tie-in sales and predatory pricing pose a competitive threat to financial markets, they should be subject to the same antitrust scrutiny that would apply to such activities in any other industry.

Noncompetitive Concerns

A number of additional, noncompetitive concerns commonly surface in a debate about the merits of "concentration" or "firm size" in financial markets. They fall into four general categories: conflicts of interest, the safety and soundness of the financial system, the potential political power of large financial institutions, and the allocation of credit among competing interests. In general, these concerns focus more on scale than on concentration; and, while they have all been narrowly directed at banks at one time or another, they are broadly applicable to all kinds of financial institutions.

Conflicts of Interest. Conflicts of interest occur when there are two or more competing interests present and the person or firm making a decision affecting those interests has a larger stake in one of the interests than in the other but is expected, indeed required, to serve each interest equitably, regardless of his or its own stake.

Conflicts, so defined, are pervasive: they are not unique to financial institutions or to banks in particular. Nevertheless, since financial

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institutions, especially banks, are seen as having a higher order of fiduciary responsibility than other firms, conflicts have always been a controversial issue in the financial area.

This issue has several dimensions, which must be carefully distinguished. Much of the controversy relates to the type of organization of the firm: for example, a holding company versus a single, integrated company. It is often argued that holding companies are subject to conflicts of interest because of the differing capital structures of their affiliates and subsidiaries. The essence of this debate is whether these conflicts (and incentives) can or cannot be adequately controlled by regulation. Unfortunately, the proponents of the alternative positions support their views with little more than their own judgments about the ability of regulators to monitor and control such conflicts.

Will the current structural evolution, by increasing the size of financial institutions, increase the conflicts problem, either by decreasing competition or by decreasing the information available to the customers or the debt holders of banks and other financial institutions? It is generally recognized that in the absence of competitive and information imperfections conflicts cannot disadvantage customers or debt holders. It seems unlikely that large size by itself will exaggerate whatever imperfections already exist. In fact, serious conflicts may be more common in small institutions than in large institutions. The predominant form of organizational structure among large financial institutions today is the holding company, in which the parent owns all (or the vast majority) of the subsidiaries. This can be contrasted with our historical financial structure, populated by small local institutions, in which owners (or managers) often had personal equity interests in the business activities of their customers. Under these conditions, the incentive to favor one set of customers to the detriment of others is strong. That incentive is considerably muted if the institution itself has total ownership of all its subsidiaries and does not *have equity interests in its customers' businesses*. Large size, therefore, may result in fewer potential conflicts than exist in smaller financial institutions.

In addition, discriminatory treatment of certain interests (or customers) by managers implicitly assumes that these interests are not in a position to know what is happening to them—that they cannot monitor the institution effectively. Large institutions, to the extent that they discriminate at all, are likely to do so between different kinds of interests (or types of customers) and not between *individual* customers. It would be bureaucratically cumbersome to discriminate any other way. Thus, if any customers within a group can monitor the

institution effectively, all customers within that group will be protected. This together with the current trend toward making more information available about all aspects of financial institutions' activities provides a significant check on abusive managerial behavior.

Increased competition is another check on managerial behavior. If customers have alternatives, they will go elsewhere if not fairly treated. The current structural evolution will increase competition, providing a more effective check on managerial abuses. Abusive behavior is a luxury that competitive firms cannot long afford. Thus, there is little reason to think that larger firm size in financial markets will increase the problems commonly associated with conflicts of interest. Indeed, the reverse is more likely.²⁰

Safety and Soundness. Another consideration, more often directed at banks than at nonbank financial institutions, is the "safety and soundness" of the financial system. Will a system of predominantly large banks be more or less susceptible to instability than the present one? Or, alternatively, must our present regulatory structure for maintaining financial soundness be altered to accommodate a system of large banks?

The first question is whether large banks are more or less prone to insolvency. We would expect them to be less vulnerable to insolvency. Large banks are more diversified, have better access to capital markets, and, in general, are probably better managed. Thus the probability of failure for a large bank should be less than for a small bank.

A structure of large banks, however, may pose additional concerns. Interdependence among large banks, it is feared, may cause the failure of one to precipitate the failure of others, so that the failure of a single large bank may expose the federal deposit insurance system to greater risk of insolvency.²¹

Some who harbor this concern cite the law of large numbers for support. This law states that as the number of exposure units (such as banks) increases, the more certain it is that actual loss experience will equal the probable (or the expected) loss experience. Hence, insurance risk (or uncertainty) will increase as the number of exposure units decreases. Under certain assumptions, such risk can be shown to vary inversely with the square root of the number of banks.

The law of large numbers requires that certain key assumptions be met before its implications are valid. First, the probability of bankruptcy is assumed to be the same for all banks; second, bank insolvencies are assumed to be completely independent of one another; and, third, all units are assumed to be of identical size. None of these

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assumptions is valid for banking: large banks should have a lower probability of insolvency, interdependence is likely, and there is obviously a size disparity among banks. Standard insurance theory, therefore, cannot be used to determine whether a system of large banks poses a greater threat to financial soundness.

Another concern is that market discipline will be undermined because regulators may not allow a large bank to fail. But bank failures need not mean market disruption or even customer inconvenience. They can be accomplished by simply replacing old owners with new owners. The losses can be borne entirely by the old owners if regulators act in a timely fashion, "closing" banks before the market value of their equity is less than zero. The restructuring of large banks does not pose any special problems.²²

Finally, a historical comparison among countries suggests that the U.S. financial structure has been more susceptible to financial panics (or "bank runs") than have other countries' financial systems.²³ Since the financial structures of other countries are characterized by relatively fewer and larger banks (in contrast to the U.S. system of thousands of small, independent banks), this suggests that a system of large banks may be less vulnerable to insolvency and instability. A structure characterized by large banks and financial institutions, however, makes it more urgent that we rethink the current deposit insurance system. A flat premium structure, together with the current policy of de jure less-than-full deposit insurance but de facto full coverage, seems dangerously inappropriate. A world populated by large financial institutions may also require a more active central bank lender-of-last-resort policy. We need to determine the ramifications of such a policy.

Political Power. The fear that large financial institutions operating in concentrated markets may be able to exercise substantial political power has kept many from enthusiastically endorsing the current financial evolution. This concern stems from the belief that large firms have disproportionate political power (relative to smaller competitors) and that high concentration facilitates the exercise of such power.

Large size, however, must be distinguished from concentration. Large firms can exist in markets without necessitating high concentration, and high concentration can occur without necessitating large firms. Thus, the theory used to analyze the political influence of large firms need not be the same as that used to explore the relationship of concentration to political power.

The general issue of the relationship between firm size and political power does not seem particularly germane to the changes taking

place in financial markets. First, there are already very large firms outside banking and finance (such as IBM and Exxon). The “bigness” issue is not unique to banking or financial markets. With respect to political influence, there would seem to be little difference between a large bank and either a large manufacturing firm or a large insurance company. Second, while we can expect existing financial institutions to become even larger, the size distribution of banks and other financial firms in the future will probably be less skewed than at present. This may work to neutralize (or offset) any disproportionate political power that large institutions may have.

Do firms in concentrated markets exercise greater political power? The view that they do rests on two premises. First, firms in concentrated markets may have greater (monopoly) profits. If the managers of these firms have discretionary authority—perhaps because stockholders either have difficulty monitoring management or must bear significant costs to do so—they may elect to use some of the firm’s profits to obtain political influence. Indeed, stockholders might even approve of such activity if it increased profits. Thus, in its most simplistic form, firms in concentrated markets are viewed as simply having disproportionately more resources to employ to win political concessions.

The second premise rests on a “transaction cost” argument: in concentrated markets there are fewer firms with more homogeneous interests; so it costs less to organize a political campaign. The costs of having to bring together many firms with diverse interests is avoided. If both the average and the marginal costs of a given political action are less, it stands to reason that the marginal (net) benefit of such action for a given total resource expenditure will increase. Thus, firms may choose to spend more on political action and less on something else. The result may be that they have greater political influence.

This view has found credence in the literature of political economy. For example, Vogel argues that

companies in concentrated industries do appear to enjoy an important advantage: firms in these industries are more readily able to perceive their political interests and can more easily communicate with each other. To the extent that firms in more concentrated industries are often relatively large, this advantage is reinforced: larger firms are more able to monitor political developments, analyze and document the impacts of various public policies, and support a Washington office than are smaller firms. While this does not automatically translate into political power, it certainly constitutes a necessary condition for its exercise.²⁴

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In addition, fragmented or unconcentrated markets may be subject to free-rider problems. An individual company may be unwilling to put substantial time, effort, and money into a political campaign for fear that others will not do the same.

This view is not without its dissenters. In discussing the political power of the 200 largest corporations, L. E. Birdzell takes the contrary position:

The argument that conglomerates represent a political power threat is . . . difficult to take seriously. A large concentration of wealth undoubtedly has a substantial political capability if it can lawfully be applied to political purposes, as illustrated by the successful political use of Rockefeller and Kennedy fortunes. The fatal problem with similar political use of corporate concentrations of wealth is that they cannot lawfully be applied to political uses, even if stockholders could be induced to agree on common political objectives and the business organization could survive the necessary diversion of effort. Salaried corporate managers are probably not as rich a potential source of political contributions as oil lessors, owners of automobile dealerships, and other entrepreneurs with substantial personal fortunes. And corporate management is rarely able to deliver the votes even of corporate stockholders, let alone employees, dealers or suppliers. The Automobile Dealers Day-in-Court Act is eloquent testimony to the comparative political power of some very large corporations on the one hand and a group of "small" businessmen on the other.²⁵

In a study of special interest legislation, Richard Posner also concludes that large corporations have no more influence in the political process than small firms:

The fact that a great deal of legislation appears to be designed to protect firms against competition . . . provides the basis for a serious criticism of our political system and, perhaps, more broadly, of the role which we allow "interest groups" to play in shaping public policy. It does not suggest a basis for a criticism of large corporations as such. The subordination of consumer to producer interests in the production of legislation seems quite independent of the size of the individual firms involved. We observe as much protective legislation in small business industries, such as agriculture, textiles, and trucking, as in large—perhaps more. We observe much protective legislation in industries where production is carried on by individuals rather than by firms—unionized trades

(barbering, plumbing, pharmacy) and regulated professions such as medicine are more important examples.²⁶

With respect to the financial services industry in particular, some of the assumptions that underlie the argument that large firms will have disproportionate political influence may not be correct. To begin with, the current structural evolution is likely to increase competition by lowering entry barriers into all markets. Thus there will be less "discretionary" profits in the future to support political activities—political influence may diminish, not increase. Second, to the extent that concentration contributes to "efficiency" of political action, that may not necessarily be bad. In a democratic (indeed, any) society, political action and influence are a fact of life. It is not clear that, if large firms are a more effective vehicle for political action, the result will be a worse "social contract." There are large firms in other industries, large unions, and many large influential organizations that represent otherwise small economic interests.

There is, in addition, little empirical evidence to suggest that large banks have wielded disproportionate political power in the past.²⁷ The few studies of which I am aware fail to find a relationship between bank size, concentration, and political influence. For example, John Rose tests the hypothesis that domination of a state by a few banks may enable such banks to get laws passed that are favorable to themselves. He could find no relationship between state banking concentration and the votes of state senators on a bill to delay the introduction of nationwide negotiable order of withdrawal (NOW) accounts, however.²⁸

In another study Linda Edwards and I investigated the relationship of both concentration and firm size to (regional) statutory interest rate ceilings on consumer loans.²⁹ A wide disparity of rate ceilings exists among states. The ceilings vary from a low of 10 percent to over 40 percent. We attempted to determine if rate ceilings were higher in states with a higher concentration among finance companies (the beneficiaries of high rate ceilings) or were lower in states with a greater number of finance companies. The results revealed no relationship between the level of states' rate ceilings and either concentration or number of firms.

Thus, there is no evidence that the structural evolution in financial markets will allow banks and other financial institutions to acquire unacceptable political power. Further, to the extent that an issue of political power exists, there is no reason to single out banks and financial institutions for special treatment. In this respect financial institutions are no different from other firms in other markets. They

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too can acquire and use political power. If a policy is needed to control the political power exercised by large firms or by firms in concentrated markets, this policy should have universal application: it should apply to all firms in all markets and not only to banks and financial institutions.

Credit Allocation. It has been alleged that a more concentrated financial structure will result in an undesirable reallocation of credit. For example, in a recent letter to the *Washington Post*, Senator William Proxmire, chairman of the Committee on Banking, Housing, and Urban Affairs, says:

Separating banking and commerce has fostered a vibrant economy based on small business. Small banks lend almost exclusively to small businesses, which account for 85 percent of job creation. (Only 13 percent of a large bank's loan portfolio is with small businesses.) When banking and commerce are mixed, the result is a higher concentrated industry dominated by huge companies.³⁰

This statement typifies the confusion surrounding the issue of credit allocation. First, it presumes that the consolidation of financial institutions into larger entities will result in a "highly concentrated industry dominated by huge companies." Read uncritically, this statement seems to say that competition will diminish. While it is true that consolidation will result in fewer and larger institutions, it does not follow that competition will be less. As discussed earlier, it is concentration in *relevant* markets that is critical, and, for reasons already discussed, the number of viable competitors in relevant markets will probably increase rather than decline. Further, even if this does not occur (or there are fewer "actual" competing institutions), competition is nevertheless likely to increase because entry barriers into these markets will be lower. Either way, the result is likely to be more, not less, competition.

Second, as indicated by his citing of statistics on the percentage of bank portfolios devoted to small business credit, Senator Proxmire confuses concentration with absolute bank size. He suggests that large banks may not serve the credit needs of small businesses as well as small banks do. His evidence is the lower percentage of a large bank's portfolio (13 percent) dedicated to small businesses. This is a misleading statistic: a smaller percentage of a larger pie may result in a larger (in absolute size) piece of pie than would a larger percentage of a smaller pie. Taken alone, the percentage of large versus small bank portfolios is meaningless. What matters is the *total* credit going to

small businesses. It is easy to show that even if large banks were to devote a significantly lower percentage of their loan portfolios (the larger pie) to small businesses than small banks do, the total credit going to small businesses would increase, not decrease.

The concern about large banks sometimes stems from a belief that branch managers of large banks (or other financial firms) are not as responsive to local borrowers' needs as are local bankers. Local bankers, it is alleged, have a better understanding of local conditions and are better able to assess a borrower's credit worthiness. Further, they have the long-run interests of the community in mind.

Although it is difficult to evaluate this argument, a number of arguments can be made on the other side. First, branch banks may also have a long-run interest in a community. Why should they not? It is in their interest, just as it is for local bankers, to foster long-term, profitable banking relationships. Second, branch offices may be staffed by citizens of the local community, who possess the same knowledge about the community and its borrowers as do local, independent bankers. Third, it is at least conceivable that local bankers, because of their familiarity with local borrowers and their independence of action, may misjudge the ability of borrowers. They may not make objective assessments. Last, we have already had extensive experience with branching and with large branch banks. There is no evidence that local (or small) customers in branching states receive poorer financial service. It is, therefore, difficult to put much weight on the contention that large branch banks will not provide services of equal quality to local customers.

More important, the entire argument that we should be concerned about the effects of a revised financial structure on credit allocation is spurious. The new financial structure that will develop because of fewer regulatory restrictions will bring about a further integration of financial markets. Institutions will have offices in many locations and will quite naturally shift credit to areas and borrowers with the greatest need. Borrowers (of a given credit standing) who are willing to pay more for credit will receive the credit. Since borrowers who are willing and able to pay more presumably have more productive (or higher-yielding) uses for the credit, the result is a more efficient allocation of credit. Credit will flow to its most productive uses.

Credit should be priced and allocated like any other productive resource, such as labor. A more integrated financial structure will result in a more efficient allocation of credit and capital than we now have. If the result is a shift of credit away from one group of borrowers (say small businesses) toward another group (say households), this is

probably welfare enhancing, just the opposite of what is suggested by Senator Proxmire's letter. There is nothing sacred about the existing distribution of credit. Credit allocation should depend upon the realities of market economics, not upon a financial structure that may be more reflective of historical accident than of sound economics.

There is, finally, one more argument against using a particular (or peculiar, depending on one's point of view) institutional structure to allocate credit to foster specified *real* economic objectives: it does not work.

Unless unacceptably severe restrictions are imposed, attempts to influence real investment or real spending on certain products or in certain areas of the country through credit allocation schemes are doomed to failure. Such efforts run counter to a key proposition in credit theory: the fungibility of credit. Credit fungibility permits investors to look beyond the superficial differences among securities in pursuit of high yields and low risk. Borrowers can transform an apparently designated loan into a source of general funds to be used for anything.

A home mortgage, for example, is merely a loan collateralized by a house. The house can be old or new. If the mortgage rate is lower because of an institutional structure that forcibly channels credit into mortgage lending, homeowners can refinance their homes. Home buyers can make smaller down payments to take advantage of the cheap credit too. In both cases lowering the cost of credit leads to increased mortgage lending, but in neither case need it affect housing construction. In other words, making more mortgage or small business credit available need not result in more housing or greater growth of small businesses; it may simply lead to more loans against existing houses or small business assets. This effect is certainly different from that which Senator Proxmire had in mind.

If there is a clear social goal to affect real economic activity in particular sectors of the economy, tampering with the institutional structure of financial markets is not the way to achieve it. A more direct tax or subsidy program is preferable. Such a program can work, and its costs can be made explicit.

Thus, fears that a new, more concentrated financial structure will alter credit flows in undesirable ways are misplaced and unfounded. We have, to the contrary, reason to believe that the resulting allocation of credit will be superior to that which we now have.

The Law and Policy Governing Competition

Policy governing both mergers and acquisitions (among banks and other financial institutions) and unfair competitive practices involves

the complex application of several different bodies of law by several different regulatory authorities. This section discusses that policy as it applies to banks and thrifts.

Mergers and Acquisitions. Concern that a merger or acquisition between banks or thrift institutions will reduce competition can cause both the federal and thrift regulatory agencies and the Department of Justice to review the transaction and, if deemed necessary, intervene to prevent it from going forward.

There are several steps in this process.³¹ First, the relevant bank and thrift regulatory agencies perform an initial competitive review. Under the Bank Merger Act of 1966, the Office of the Comptroller of the Currency (OCC) for national banks, the Federal Deposit Insurance Corporation (FDIC) for federally insured state-chartered banks that are not members of the Federal Reserve System, and the Federal Reserve Board of Governors (FRB) for state-chartered banks that are system members are required to conduct their own competitive analysis and to obtain competitive factor reports from each other and from the Department of Justice before approving a bank merger. (These transactions are exempt from Hart-Scott-Rodino Act premerger notification procedures.)

Under the Bank Holding Company Act the FRB must apply a competitive analysis before approving the acquisition of a bank (or bank holding company) by a bank holding company. Although competitive factor reports are not required, the FRB sends applications—exempt from Hart-Scott-Rodino premerger notification requirements—to the Department of Justice. Copies of applications for bank holding company acquisitions of nonbanks submitted must be filed with the antitrust agencies under Hart-Scott-Rodino at least thirty days before consummation, if the transaction is to be exempted from normal Hart-Scott-Rodino filing requirements. Thus, the Antitrust Division, like the FRB, reviews these transactions to assess their competitive effects.

The Federal Home Loan Bank Board (FHLBB) reviews mergers of savings and loan associations under regulations providing for analysis of competitive effects, as does the Federal Savings and Loan Insurance Corporation (FSLIC) for federally insured thrifts under its regulations. To satisfy the Hart-Scott-Rodino requirements, the parties seeking an exemption must file a copy of the application submitted to the thrift agency with the Department of Justice and the Federal Trade Commission.

For savings and loan holding company mergers and acquisitions, the FHLBB conducts competitive reviews and also requests competi-

tive factor reports from the Department of Justice. No Hart-Scott-Rodino filing is required.

Second, the Antitrust Division of the Department of Justice screens all the applications it receives, whether from the agencies or through the Hart-Scott-Rodino process. Its objective is to identify those that exceed the standards of the Department of Justice Merger Guidelines as applied to depository institutions. Analysis under the guidelines centers on three factors: the product market, the geographic market, and the likely anticompetitive effects of the transaction within those markets. This analysis is similar to the legal elements considered under section 7 of the Clayton Act, which bars a merger or acquisition "where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly."

Next, after the screening and the initial analyses have been completed, the Antitrust Division decides whether the merger or acquisition should be opposed because it is "significantly adverse to competition." The standard used for this determination is that, unless other factors indicate an anticompetitive effect, the Antitrust Division will not oppose a bank or thrift merger unless the postmerger concentration ratio exceeds a prespecified level: unless the postmerger Herfindahl-Hirschman index (HHI) is 1,800 or greater and the HHI increase due to the transaction is at least 200 points.³²

If the Antitrust Division concludes that a transaction is "significantly adverse to competition," it sends a full-blown competitive-factors report to the responsible agency. In all other instances where required by statute, the division sends only a short-form competitive-factors report, concluding that the transaction is "not significantly adverse to competition." If the regulatory agency nevertheless approves a transaction on which the Antitrust Division has submitted a "significantly adverse" letter, the division has thirty days after approval of a bank or bank holding company transaction to decide whether to sue. If the division does not sue, the transaction becomes immune from challenge except under section 2 of the Sherman Act. If suit is brought, the transaction is automatically stayed. Neither the time limit for an antitrust challenge nor the statutory stay, however, applies to savings and loan associations or savings and loan holding company transactions.

In determining whether a merger or acquisition is "significantly adverse to competition," the Antitrust Division undertakes a complex and sophisticated substantive analysis of its likely competitive effects. It defines and analyzes alternative product and geographic markets³³

and evaluates the potential structural effect of the transaction in these markets. Its structural analysis encompasses both direct competition (through the concentration-ratio tests noted above) and potential competition. With respect to potential competition, such factors as entry conditions (for example, branching restrictions), advantages that the acquiring firm may have as a possible entrant, and the market share of the acquired firm are considered.

The Antitrust Division is also willing to take account of other factors that may mitigate an inference of an anticompetitive effect.³⁴ For example, it will consider evidence that the transaction will enhance efficiency by achieving economies of scale, although this argument is customarily available only in the case of very small institutions. It will take into account evidence pertaining to the financial health of the firm to be acquired (under the "convenience and needs" clause). Such evidence is persuasive to the Antitrust Division and the courts, however, only when financial failure is a danger and when no less anticompetitive alternatives exist.³⁵

In summary, with a few minor exceptions, which are more possibilities than likelihoods, the competitive standards applied by the Department of Justice to mergers and acquisitions among banking and thrift institutions are for all practical purposes identical to those imposed by the antitrust laws (in particular, section 7 of the Clayton Act). There seems to be little purpose to the cumbersome, bureaucratic, and costly screening procedures now employed by regulatory agencies and the Department of Justice. Further, as is evidenced by past developments of the law in this area, no convincing rationale has appeared for a competitive policy applicable to banks and financial institutions separate and distinct from that applied to mergers and acquisitions among nonfinancial firms.

Regional Compacts. Regional compacts, which have surfaced during recent years, are another regulatory aspect relevant to competition policy. These are arrangements among a relatively few states, often in a specific area of the country (such as New England), which permit mergers among depository institutions located within the specified region but prohibit mergers between depository institutions in the region and depository institutions outside the region.

While these compacts provide for some expansion of interstate competition, they are clearly designed to limit competition by excluding institutions outside the region as competitors. They should not, therefore, be permitted to become a permanent feature of our financial landscape. They are, at best, a short-run, transitional expedient.

Unfair Competitive Practices. Financial institutions engaging in unfair competitive practices are subject to section 1 of the Sherman Act.³⁶ In general, both tie-in sales and predatory pricing schemes that substantially lessen competition or tend to create a monopoly in any line of commerce are subject to attack under section 1.³⁷ *Fortner Enterprises, Inc. v. U.S. Steel Corp.* made it clear that the use of credit as a tying product is within the scope of the Sherman Act.³⁸ (In that case the defendant agreed to provide credit only on condition that the borrowers also purchase its prefabricated houses.)

In addition, with respect to mergers and acquisitions involving banks, section 4 (c)(8) of the Bank Holding Company Act³⁹ requires the Federal Reserve Board to consider whether the performance of the proposed activity by an affiliate of the holding company "can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices."⁴⁰ Under this provision the Federal Reserve considers all unfair competitive practices, including predatory pricing⁴¹ and tie-in sales.⁴² Finally, explicitly coerced "joint sales" are expressly prohibited by the Bank Holding Company Act.⁴³

The courts, in applying the antitrust laws, have condemned tying arrangements in cases where the tying seller is attempting to exploit its market power in the tying product to reduce competition in the tied-product market. For the arrangement to be considered a legal constraint of trade, however, the seller must have market power in the tying-product market, and there must be a substantial threat that the tying seller will be able to acquire additional market power in the tied-product market by harming existing competitors or creating barriers to entry.⁴⁴

The Supreme Court's view of predatory pricing is best captured by the following comment in *Matsushita Electric Industrial Co., Ltd.*, where it concludes that predatory pricing schemes are unlikely to succeed in reducing competition.⁴⁵ The court's view is based upon the reasoning that, for a predatory pricing scheme to be rational, a predator must maintain monopoly power in the target market long enough both to recoup its (investment) losses and to harvest additional gain. There is no assurance, however, that the hoped-for monopoly power will materialize. Indeed, to recoup its losses and gain additional profits the predator will have to set and maintain supra-competitive prices, which will attract new entrants and competitors. Thus, unless rather special conditions prevent entry into the

target market, the court is unlikely to find a predatory pricing scheme to be injurious of competition.⁴⁶

Thus, the present antitrust laws are as applicable to unfair competitive practices perpetrated by banks and financial institutions as they are to nonfinancial firms. A comparison of the legal standards imposed by these laws with our economic analyses of tie-in sales and predatory pricing schemes also reveals that these standards are consistent with sound economic analysis. We have, therefore, no reason to develop a separate body of law applicable only to banks and financial institutions. The continued application of the antitrust laws to banks and financial institutions will amply protect the public welfare.

Summary and Recommendations

Recent structural changes in financial markets have raised some concern that the ultimate result of these changes will be fewer and larger financial institutions that operate in more concentrated and therefore less competitive markets. This study has evaluated the concerns commonly associated with concentrated financial markets and with either large financial institutions or large banks. In particular, it analyzes the likely effects of the envisioned structural changes on competition in financial markets and examines several issues associated with either concentrated markets or larger firm (or bank) size: conflicts of interest, soundness of the financial system, the political power of financial institutions, and the allocation of credit. Current competition policy, as represented by our various regulatory and antitrust standards, is also reviewed and evaluated.

My major conclusions are:

1. Concentration in *relevant* product and geographical markets is unlikely to increase. While there will be fewer total banks and financial institutions in the nation, the number of competitors may well increase in relevant markets.
2. Competition will increase, not decrease. Concentration will decline in relevant markets, and, most important, entry barriers will fall because of diminished regulatory constraints. As a result, competition in financial markets will be more vigorous than ever.
3. The fear that large, multiproduct financial institutions, especially banks, will use tie-in sales and predatory pricing strategies to constrain competition is unfounded. The market conditions under which such strategies can be effective will be eroded, not enhanced, by the current evolution in financial markets. Further, present anti-

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trust laws and competitive standards provide a sufficient safeguard against abusive tying and predatory pricing strategies.

4. The present regulatory standards and antitrust laws applicable to mergers among financial institutions provide a sufficient safeguard against mergers that would significantly restrain competition. If anything, the acceptable concentration-ratio (or Herfindahl-Hirschman index) levels specified in the current Antitrust Guidelines are unnecessarily restrictive for the maintenance of competitive markets, and the importance attached to potential entry is too little.

5. The existence of large, multiproduct financial institutions will not exacerbate the conflict-of-interest problem. Indeed, with more competitive markets and better information, there will be less need for concern.

6. A financial system populated by large banks and financial institutions is likely to be more stable than the one we now have. There is no evidence to support the contrary view.

7. While the potential political power of large banks and financial institutions is of concern, no evidence suggests that large firms, or firms that operate in concentrated markets, have unusual political power. Existing empirical studies have not been able to discover a relationship between either firm size or concentration and political influence. Further, it is not clear why large financial institutions or large banks should be treated differently from other large firms. If there is a reason to impose restrictions on size or concentration out of a fear of excessive political power, such a policy should be extended to all firms and markets, not just to financial institutions or banks.

8. The argument that the development of large banks and financial institutions will have an adverse effect on the allocation of credit is without substance. We have, in the first place, no reason to think that the overall allocation of credit in the country is affected by the size of banks or financial institutions. Second, the development of large, multiproduct, multiregional institutions should make credit markets even more nearly perfect than they already are. If there is a reallocation of credit, therefore, it is likely to be market driven. Thus, if credit reallocation occurs, it should increase welfare, not reduce it.

9. Finally, no purpose seems to be served by continuing the bureaucratic and costly review process now used to evaluate the competitive effects of bank and thrift institution mergers. The process should be simplified so that such mergers need only meet the tests imposed by the antitrust laws.

Appendix A

TABLE A-1
SHARES OF TOTAL DOMESTIC DEPOSITS AND ASSETS OF THE TEN LARGEST BANK HOLDING COMPANIES, 1984

	Domestic Deposit Rank	Domestic Deposits (billions of dollars)	Shares of Total (%)	Domestic Asset Rank	Domestic Assets (billions of dollars)	Shares of Total (%)
All commercial banks		1,727.1	100.0		1,956.9	100.0
Ten largest companies		286.3	16.6		449.1	22.9
BankAmerica Corp.	1	68.0	3.9	1	82.3	4.2
Citicorp	2	37.1	2.1	2	76.2	3.9
First Interstate Bancorp	3	31.8	1.8	4	40.8	2.1
Chase Manhattan Corp.	4	30.2	1.7	3	51.6	2.6
Security Pacific Corp.	5	24.1	1.4	8	32.7	1.7
Manufacturers Hanover	6	23.9	1.4	5	39.1	2.0
Chemical N.Y. Corp.	7	22.6	1.3	7	37.9	1.9
Wells Fargo & Co.	8	18.5	1.1			
J. P. Morgan & Co.	9	15.2	0.9	6	38.1	1.9
First Chicago Corp.	10	14.9	0.9	9	25.9	1.3
Bankers Trust N.Y. Corp.				10	24.5	1.3

Sources: Federal Reserve Board, BHC Financial Data, December 31, 1984, and flow of funds accounts as of December 31, 1984.

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TABLE A-2
ASSETS OF THE TEN LARGEST U.S. FINANCIAL ENTERPRISES,
YEAR-END 1985
(billions of U.S. dollars)

	Assets
Citicorp	173.6
BankAmerica Corp.	118.5
Federal National Mortgage Association	99.1
Prudential Insurance	91.1
Salomon Bros., Inc.	88.6
Chase Manhattan Corp.	87.7
Manufacturers Hanover	76.5
Metropolitan Life	76.5
GMAC	75.4
American Express	74.8

NOTE: Domestic assets of these companies are smaller than their total assets, and for bank holding companies domestic assets are relatively smaller than for the other firms.

SOURCE: *Fortune*, June 9, 1986, pp. 122-35.

TABLE A-3
SHARES OF TOTAL INDUSTRY CAPITAL OF
THE TEN LARGEST SECURITIES FIRMS, 1984

	Capital (millions of dollars)	Share (%)
All firms	11,609.4	100.0
Ten largest firms	6,313.5	54.4
Merrill Lynch & Co., Inc.	1,685.3	14.5
Salomon Bros., Inc.	1,051.1	9.1
Shearson/American Express Inc.	836.6	7.2
E. F. Hutton Group Inc.	608.1	5.2
Goldman, Sachs & Co.	478.0	4.1
Prudential-Bache Securities Inc.	442.9	3.8
First Boston, Inc.	321.1	2.8
Paine Webber Incorporated	313.7	2.7
Dean Witter Reynolds Inc.	300.9	2.6
Bear, Stearns & Co.	275.8	2.4
Total number of firms	339	

SOURCE: *Institutional Investor* (April 1984), pp. 267-69.

TABLE A-4
TEN LARGEST U.S. MUTUAL FUND MANAGERS, 1986

	<i>Billions of Dollars</i>	<i>Percentage of Total Industry</i>
Merrill Lynch Asset Management Inc.	64.7	10.0
Fidelity Investments	53.7	8.3
Federated Investors Corp.	38.8	6.0
Dreyfus Corp.	37.5	5.8
Franklin Resources	29.7	4.6
Shearson/Lehman Bros. Inc.	29.7	4.6
Dean Witter Reynolds	29.1	4.5
Vanguard Group	25.2	3.9
Kemper Financial Services	23.9	3.7
Putnam Management Co.	20.0	3.1

SOURCE: "The 1986 Annual Mutual Fund Survey," *Forbes*, September 8, 1986, pp. 104-226.

TABLE A-5
SHARES OF TOTAL INDUSTRY ASSETS OF
THE TEN LARGEST LIFE INSURANCE COMPANIES, 1984

	<i>Assets (billions of dollars)</i>	<i>Shares of Total (%)</i>
All companies	723.9	100.0
Ten largest companies	352.7	48.7
Prudential	78.9	10.9
Metropolitan	67.4	9.3
Equitable	44.5	6.1
Aetna	34.0	4.7
New York Life	25.6	3.5
John Hancock	24.7	3.4
Travelers	23.3	3.2
Connecticut General	19.2	2.7
Teachers	19.2	2.7
Northwestern Mutual	15.9	2.2

SOURCES: *Life Insurance Fact Book*, 1985; *A. M. Best's Guide to Life Insurance Companies—1985 Edition*; and *Fortune*, June 10, 1986, pp. 188-89.

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TABLE A-6
 SHARES OF TOTAL INDUSTRY ASSETS OF THE TEN LARGEST
 PROPERTY AND CASUALTY INSURANCE COMPANIES, 1984

	<i>Assets</i> (billions of dollars)	<i>Shares of</i> <i>Total</i> (%)
All companies	264.7	100.0
Ten largest companies	115.2	43.5
Travelers Group	31.7	11.9
State Farm Group	19.9	7.5
Aetna Life and Casualty Group	12.1	4.6
Allstate Insurance Group	11.9	4.5
CIGNA Group	10.1	3.8
Liberty Mutual Insurance Co.	8.2	3.1
Hartford Insurance Group	6.9	2.6
Continental Insurance Group	5.1	1.9
Farmers Insurance Group	4.9	1.9
Fireman's Fund (AMEX)	4.4	1.7

SOURCES: 1985-86 *Property/Casualty Fact Book*; and A. M. Best's *Insurance Reports, P&C Companies—1985 Edition*.

TABLE A-7
SHARES OF TOTAL DOMESTIC DEPOSITS AND ASSETS OF THE TEN LARGEST THRIFT INSTITUTIONS, 1984

	Deposit Rank	Deposits (billions of dollars)	Shares of Total (%)	Asset Rank	Assets (billions of dollars)	Shares of Total (%)
All thrifts		965.1	100.0		1,181.3	100.0
Ten largest thrifts		120.7	12.5		158.1	13.4
American S&L Assn., Calif.	1	20.3	2.1	1	28.9	2.4
Home Savings of America, Calif.	2	18.6	1.9	2	23.7	2.0
Great Western Savings, Calif.	3	16.7	1.7	3	21.7	1.8
California FS&L, Calif.	4	14.3	1.5	4	17.7	1.5
PSFS, Philadelphia, Pa.	5	11.0	1.1	5	13.7	1.2
Goldome FSB, Buffalo, N.Y.	6	9.8	1.0	7	11.2	0.9
Glendale FS&L, Calif.	7	8.9	0.9	6	11.7	1.0
World Savings FS&L, Calif.	8	7.5	0.8	8	10.6	0.9
Empire of America FSB	9	6.9	0.7			
Home FS&L, Calif.	10	6.7	0.7	9	9.5	0.8
First Federal of Michigan				10	9.4	0.8
First Nationwide S&L, Calif.						

SOURCES: FHLB, Combined Financial Statements, December 31, 1984; National Council of Savings Institutions, *Economic Update*, December 31, 1984; and *American Banker*, February 28, 1985.

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TABLE A-8: SHARE OF TOTAL INDUSTRY BASE OF
THE TEN LARGEST FIRMS, BY RANK OF CONCENTRATION, 1984

<i>Industry</i>	<i>Number of Firms</i>	<i>Top Ten Share of Total (percent)</i>	<i>Base</i>	<i>Total Base (billions of dollars)</i>
Securities	339	54.4	Capital	11.6
Life insurance	2,134	48.7	Assets	723.9
Property and casualty insurance	3,468	43.5	Assets	264.7
Commercial banks	15,000	22.9	Assets	1,956.9
		16.6	Deposits	1,727.1
Thrift institutions	3,521	13.4	Assets	1,181.3
		12.5	Deposits	965.1

SOURCES: See sources for tables A-1, A-3, A-5, A-6, and A-7.

TABLE A-9
TEN LARGEST COMMERCIAL BANKS IN THE WORLD, 1970 AND 1986
(by dollar value of assets)

<i>Bank</i>	<i>Rank in 1986</i>	<i>Rank in 1970</i>
Ten largest in 1986		
Citicorp, United States	1	2
Dai-Ichi Bank, Japan	2	38
Fuji Bank, Japan	3	13
Sumitomo Bank, Japan	4	17
Mitsubishi Bank, Japan	5	16
Banque Nationale de Paris, France	6	15
Sanwa Bank, Japan	7	18
Credit Agricole, France	8	
BankAmerica, United States	9	1
Credit Lyonnais, France	10	21
Ten largest in 1970		
Bank America, United States	9	1
Citicorp, United States	1	2
Chase Manhattan, United States	19	3
Barclays Group, United Kingdom	16	4
Manufacturers Hanover, United States	27	5
J. P. Morgan, United States	31	6
National Westminster Bank, United Kingdom	12	7
First Interstate Bancorp, United States	53	8
Banca Nazionale Del Lavoro, Italy	39	9
Chemical New York, United States	43	10

SOURCE: *Banker* (August 1986), pp. 58-70.

Appendix B: Changes in Banking Concentration, 1966-1981

Trends in Local Market Concentration. The general tendency has been for concentration (defined by concentration ratio: the three-bank deposit ratio) to decline in most local banking markets. Tables B-1, B-2, and B-3 describe the changes in concentration over the period 1966-1976 in 152 standard metropolitan statistical areas (SMSAs) and in 129 counties. The concentration data are presented separately for SMSAs and counties according to whether they are in states classified as expansion or nonexpansion states. Expansion states are those considered more liberal with respect to either bank holding company affiliates or branch offices. Tables B-1 and B-2 show that in a large majority of local banking markets there have been decreases in concentration. Further, this tendency, surprisingly, is more pronounced in markets in nonexpansion states.

TABLE B-1
NUMBER OF SMSAs WITH CHANGES IN CONCENTRATION IN
EXPANSION AND NONEXPANSION STATES, 1966-1976

	<i>Number of SMSAs in Expansion States with Changes in Concentration Ratio</i>			<i>Number of SMSAs in Nonexpansion States with Changes in Concentration Ratio</i>		
	Increases	Decreases	None	Increases	Decreases	None
1966-70	15	86	1	7	41	2
1970-76	22	79	1	5	45	0
1966-76	16	86	0	2	48	0

SOURCES: Steven A. Rhoades, "Geographic Expansion of Banks and Changes in Banking Structure," Staff Memorandum (Washington, D.C.: Board of Governors of the Federal Reserve System, 1979); and idem, "Size and Rank Stability of the 100 Largest Commercial Banks, 1925-1978," *Journal of Economics and Business*, vol. 34, no. 2 (1982), pp. 123-28.

Table B-3 shows the magnitude of changes in local market concentration that have occurred between 1966 and 1976. While the changes in expansion and nonexpansion states are quite similar, nonexpansion states show a somewhat larger decrease.

TABLE B-2
NUMBER OF COUNTIES WITH CHANGES IN CONCENTRATION IN
EXPANSION AND NONEXPANSION STATES, 1966-1976

	<i>Number of Non-SMSA Counties in Expansion States with Changes in Concentration Ratio</i>			<i>Number of Non-SMSA Counties in Nonexpansion States with Changes in Concentration Ratio</i>		
	Increases	Decreases	None	Increases	Decreases	None
1966-70	15	32	6	18	45	13
1970-76	13	32	8	11	57	8
1966-76	15	34	4	11	58	7

SOURCES: Same as sources for table B-1.

TABLE B-3
AVERAGE CHANGE IN CONCENTRATION IN SMSAs AND COUNTIES IN
EXPANSION AND NONEXPANSION STATES, 1966-1976

	<i>Average Change in SMSA Concentration Ratio</i>		<i>Average Change in Non-SMSA County Concentration Ratio</i>	
	Expansion states	Nonexpansion states	Expansion states	Nonexpansion states
1966-70	-2.37	-2.71	-1.12	-1.05
1970-76	-4.02	-4.88	-1.89	-2.63
1966-76	-6.39	-7.60	-3.01	-3.69

SOURCE: Rhoades, "Geographic Expansion."

Table B-4 shows the average percentage changes in local market concentration separately for all states for the period 1966-1981. The mean decrease in the concentration ratio is 10.28 percent. Thus concentration is clearly declining in local banking markets.

TABLE B-4
 AVERAGE AND AVERAGE PERCENTAGE CHANGE IN
 CONCENTRATION RATIO IN SMSAs AND SELECTED COUNTIES,
 BY STATE, 1966-1981
 (commercial banks only)

	<i>Average Concentration</i>			<i>Average Percentage Change^a</i>		
	1966	1973	1981	1966-73	1973-81	1966-81
Alabama	83.5	77.3	72.5	-7.5	-6.2	-13.2
Alaska	96.6	89.8	71.7	-7.1	-20.1	-25.8
Arizona	91.9	89.9	86.4	-2.2	-3.9	-6.0
Arkansas	81.9	79.7	79.0	-2.6	-0.9	-3.5
California	79.2	73.4	68.3	-7.3	-6.9	-13.7
Colorado	76.9	71.7	67.1	-6.8	-6.4	-12.8
Connecticut	85.3	79.5	73.7	-6.8	-7.3	-13.6
District of Columbia	41.6	38.3	38.5	-8.0	0.4	-7.6
Florida	65.9	62.0	54.6	-5.9	-11.9	-17.1
Georgia	91.8	86.0	83.6	-6.4	-2.7	-9.0
Hawaii	78.0	74.5	77.2	-4.5	3.6	-1.1
Idaho	93.7	88.6	82.1	-5.4	-7.3	-12.3
Illinois	63.7	59.4	55.8	-6.7	-6.2	-12.4
Indiana	80.3	78.0	76.2	-2.8	-2.4	-5.1
Iowa	77.5	74.7	73.5	-3.7	-1.6	-5.2
Kansas	76.8	68.8	66.9	-10.4	-2.7	-12.9
Kentucky	84.4	82.9	81.2	-1.8	-2.1	-3.8
Louisiana	85.8	81.9	76.8	-4.5	-6.3	-10.5
Maine	95.9	92.9	95.5	-3.2	2.9	-0.4
Maryland	55.1	51.0	51.0	-7.4	0.1	-7.3
Massachusetts	82.6	80.5	77.2	-2.5	-4.2	-6.6
Michigan	82.2	78.6	76.3	-4.4	-2.8	-7.1
Minnesota	69.8	67.2	63.7	-3.7	-5.3	-8.8
Mississippi	96.0	93.2	87.9	-2.9	-5.7	-8.4
Missouri	67.9	64.3	63.8	-5.4	-0.8	-6.1
Montana	96.7	90.7	87.8	-6.2	-3.1	-9.1
Nebraska	89.8	84.0	76.2	-6.4	-9.3	-15.1
Nevada	93.7	90.0	84.9	-4.0	-5.7	-9.4
New Hampshire	92.3	89.9	75.9	-2.6	-15.5	-17.7
New Jersey	66.9	61.2	59.1	-8.5	-3.4	-11.6

(Table continues)

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TABLE B-4 (continued)

	<i>Average Concentration</i>			<i>Average Percentage Change^a</i>		
	1966	1973	1981	1966-73	1973-81	1966-81
New Mexico	99.0	96.6	87.8	-2.4	-9.0	-11.3
New York	80.8	77.8	71.1	-3.7	-8.6	-12.0
North Carolina	84.9	76.6	72.9	-9.7	-4.8	-14.0
North Dakota	79.8	77.2	73.3	-3.3	-5.1	-8.2
Ohio	74.4	72.1	72.5	-3.1	0.5	-2.6
Oklahoma	77.7	73.3	66.7	-5.7	-9.0	-14.2
Oregon	91.1	87.5	77.0	-4.0	-11.9	-15.4
Pennsylvania	64.2	65.3	64.8	1.7	-0.8	0.9
Rhode Island	97.0	93.2	79.5	-3.9	-14.7	-18.1
South Carolina	75.5	59.4	57.5	-21.3	-3.1	-23.8
South Dakota	85.7	84.4	74.5	-1.6	-11.6	-13.0
Tennessee	76.7	71.6	64.5	-6.7	-9.9	-15.9
Texas	78.6	75.8	70.2	-3.5	-7.4	-10.6
Utah	58.8	62.2	54.6	5.9	-12.2	-7.0
Virginia	66.4	62.5	60.8	-5.9	-2.8	-8.5
Washington	83.8	81.2	77.6	-3.0	-4.5	-7.4
West Virginia	76.8	74.5	67.4	-2.9	-9.6	-12.2
Wisconsin	64.6	59.6	58.1	-7.8	-2.6	-10.2
Wyoming	96.5	95.9	90.0	-0.6	-6.2	-6.8

NOTE: Data for Delaware and Vermont were not available.

a. These percentage changes cannot be calculated from the data on the left side of the table. The changes shown are based on the average of the changes in individual markets.

SOURCE: Same as source for table B-3.

Trends in Statewide Concentration. The data summarized in table B-5 indicate a general tendency for statewide concentration to increase in expansion states. For the period 1960-1977, more than two-thirds (or fourteen) of the expansion states experienced an increase in statewide concentration as measured by the concentration ratio. Only twelve of twenty-eight nonexpansion states had increases in concentration during the same period.

TABLE B-5
NUMBER OF EXPANSION AND NONEXPANSION STATES
WITH CHANGES IN CONCENTRATION, 1960-1977

	<i>Number of Expansion States with Changes in Concentration Ratio</i>		<i>Number of Nonexpansion States with Changes in Concentration Ratio</i>	
	Increases	Decreases	Increases	Decreases
1960-70	11	9	10	18
1970-77	12	8	11	17
1960-77	14	6	12	16

SOURCE: Rhoades, "Size and Rank Stability."

Trends in Nationwide Concentration. Analysis of trends in nationwide concentration indicates the following:

- Concentration of deposits in the largest 100 banks increased from 33.7 percent in 1925 to 51.4 percent in 1978 (see table B-6).
- Deposits have become increasingly concentrated *within* the top 100 banks (see table B-7).
- The pattern of changes and the absolute levels of concentration for the 100 largest banks are very similar to what has occurred for the 100 largest industrial firms over the same period.

TABLE B-6
COMMERCIAL BANK DEPOSITS ACCOUNTED FOR
BY THE 100 LARGEST BANKS, 1925-1978
(percent)

	<i>Deposits Held by 100 Largest^a</i>	<i>Year</i>	<i>Deposits Held by 100 Largest^a</i>
1925	33.7	1953	45.1
1928	39.3	1958	46.3 (49.0)
1933	52.4	1963	47.4 (50.1)
1938	53.3	1968	48.2 (50.8)
1943	51.4	1973	49.6 (54.0)
1948	44.5	1978	51.4 (55.4)

a. Concentration ratios for 1925-1978 are based on foreign and domestic deposits for the 100 largest banks, *not* banking organizations. For the period 1958-1978 it was possible to construct deposit data for banking organizations, and the concentration ratios based on these data are shown in parentheses beginning with 1958.

SOURCE: Same as source for table B-5.

TABLE B-7
 PERCENTAGE OF THE LARGEST 100 BANKS' DEPOSITS
 ACCOUNTED FOR BY DIFFERENT GROUPS, 1925-1978

	Top 5	Top 6-10	Top 11-25	Top 26-50	Top 51-75	Top 76-100
1925	19	12	24	22	13	10
1928	23	14	23	20	12	8
1933	28	16	22	17	10	7
1938	30	15	23	15	10	7
1943	30	14	22	17	10	7
1948	30	13	22	16	11	8
1953	29	14	20	18	11	8
1958	31	13	20	17	11	8
1963	33	14	20	15	10	9
1968	33	14	20	16	10	7
1973	35	16	21	14	8	6
1978	36	15	18	13	7	6

SOURCE: Same as source for table B-5.

Notes

1. See, for example, S. Peltzman, "Capital Investment in Commercial Banking and Its Relationship to Portfolio Regulation," *Journal of Political Economy* (1970), pp. 1-26; and F. Edwards, "Managerial Objectives in Regulated Industries: Expense Preference Behavior in Banking," *Journal of Political Economy*, vol. 85, no. 1 (February 1977), pp. 147-62.

2. There are several alternative measures of concentration used in the academic literature and in antitrust proceedings. While these can sometimes render different impressions of a particular market, they are not critical to the discussion in this paper.

3. This point has been amply discussed in the academic literature. The main papers are J. C. Panzar and R. D. Willig, "Free Entry and the Sustainability of Natural Monopoly," *Bell Journal of Economics*, vol. 67 (1977), pp. 1-22; W. J. Baumol, E. E. Bailey, and R. D. Willig, "Weak Invisible Hand Theorems on the Sustainability of Prices in a Multiproduct Natural Monopoly," *American Economic Review*, vol. 67 (1977), pp. 360-65; J. C. Panzar, and R. D. Willig, "Economies of Scale in Multi-Output Production," *Quarterly Journal of Economics* (1977), pp. 481-94.

4. W. J. Baumol, "On the Proper Cost Tests for Natural Monopoly in a Multiproduct Industry," *American Economic Review*, vol. 67 (1977), pp. 811-22; R. D. Willig, "Multiproduct Technology and Market Structure," *American Economic Review*, vol. 69 (1979), pp. 346-51; R. D. Willig and W. J. Baumol, "Intertemporal Unsustainability," ms., 1980; E. E. Bailey, "Contestability and the Design of Regulatory and Antitrust Policy," ms., 1980; and W. J. Baumol,

J. C. Panzar, and R. D. Willig, *Contestable Markets and the Theory of Industry Structure* (San Diego, Calif.: Harcourt Brace Jovanovich, 1982).

5. See appendix A, table A-1.
6. See appendix A, tables A-2 through A-8.
7. See appendix A, table A-9.
8. See appendix B, tables B-1 through B-7.
9. See note 3.
10. See, for example, the BankAmerica-Schwab decision by the Federal Reserve Board, January 7, 1983.
11. This was the view taken by the Federal Reserve Board in BankAmerica-Schwab, p. 111.
12. *Jefferson Parish Hospital District No. 2 et al. v. Hyde*, 466 U.S.2, at 33.
13. U.S. Congress, House of Representatives, Committee on Banking and Currency, "The Growth of Unregistered Bank Holding Companies—Problems and Prospects," Staff Report of the House Committee on Banking and Currency, 91st Congress, 1st session, February 11, 1969.
14. Testimony of W. Martin before House Committee on Banking and Currency on H.R. 9385 and H.R. 6778, *Federal Reserve Bulletin*, vol. 55, no. 4, p. 334.
15. 12 U.S.C. 1972-1978.
16. *Northern Pacific R. Co.*, 356 U.S. at 6.
17. *Ibid.*
18. *Cargill, Inc. et al. v. Monfort of Colorado*, U.S. Court of Appeals, 10th Circuit, December 9, 1986, no. 85-473, at 12.
19. *Matsushita Electric Industrial Co., Ltd. et al. v. Zenith Radio Corp. et al.*, U.S. Court of Appeals, 3rd Circuit, no. 83-2004, decided March 26, 1986, at 14.
20. For another analysis of conflicts of interest, see A. Saunders, "Conflicts of Interest: An Economic View," in I. Walter, ed., *Deregulating Wall Street: Commercial Bank Penetration of the Corporate Securities Market* (New York: John Wiley & Sons, 1985), pp. 207-30.
21. See G. Kaufman, "Implications of Large Bank Problems and Insolvencies for the Banking System and Economic Policy," Staff Memorandum, SM-85-3 (Chicago: Federal Reserve Bank of Chicago).
22. See George Benston and George Kaufman, "Regulating Bank Safety and Performance," Chapter 3 in this volume.
23. See Anna Schwartz, "Financial Stability and the Federal Safety Net," chap. 2 in this volume.
24. David Vogel, "A Case Study of Clean Air Legislation 1967-81," in B. Block, ed., *The Impact of the Modern Corporation* (New York: Columbia University Press, 1984).
25. L. E. Birdzell, "The Conglomerates: A Neighbor's View," vol. 44, *St. John's Law Review* (1970), p. 314.
26. Richard Posner, "Power in America: The Role of the Large Corporation," in J. F. Weston, ed., *Large Corporations in a Changing Society*, 1975, p. 99.
27. E. Epstein, "Firm Size and Structure, Market Power, and Business Political Influence: A Review of the Literature," in J. Siegfried, ed., *The*

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Economics of Firm Size, Market Structure, and Social Performance (Washington, D.C.: Federal Trade Commission, 1980), pp. 240-81.

28. John T. Rose, "Industry Concentration and Political Leverage: An Empirical Test" (Washington, D.C.: Board of Governors of the Federal Reserve System, unpublished, 1976).

29. I. Edwards and F. Edwards, "Differential State Regulation of Consumer Credit Markets: Normative and Positive Theories of Statutory Interest Rate Ceilings," *Proceedings on Bank Structure and Competition*, Federal Reserve Bank of Chicago, April 22-28, 1978, pp. 202-36.

30. "The 'Nonbank' Threat Is Real," *Washington Post*, March 10, 1987.

31. In describing this process, I have relied extensively on a lucid exposition of the relevant issues by Robert Hauberg, Jr., assistant chief of the Antitrust Division, in a speech entitled "Mergers and Acquisitions of Depository Institutions," presented to the American Bar Association, May 23, 1985, Washington, D.C.

32. Letter from Charles F. Rule, acting assistant attorney general, to C. Todd Conover, comptroller of the currency, *First National Bank of Jackson Brookhaven Bank and Trust Company* (February 8, 1985); Letter from Charles F. Rule, acting assistant attorney general, to William M. Issac, chairman, Federal Deposit Insurance Corporation, *Indian Head Bank—Whitefield Savings Bank and Trust Company* (April 29, 1985); Letter from Charles F. Rule, acting assistant attorney general, to Paul A. Volcker, chairman, Board of Governors of the Federal Reserve System, *Savers Bancorp, Inc.—North Country Bank* (May 15, 1985).

33. See, for example, Rosenblum, DiClemente, and O'Brien, "On Banks, Nonbanks and Overlapping Markets: A Reassessment of Commercial Banking as a Line of Commerce," *Tennessee Law Review*, vol. 51(1984), p. 401; FRB decision in *Bancorp Hawis, Inc* January 24, 1985.

34. *U.S. v. Marine Bancorporation*, 418 U.S. 602, 631-32 (1974).

35. *U.S. v. Third National Bank in Nashville*, 390 U.S. 171, 187-89 (1968).

36. 26 Stat. 209 (1890), as amended, 15 U.S.C. 1 (1958). They may not be subject to section 3 of the Clayton Act, since this law covers only transactions involving "goods, wares, merchandise, machinery, supplies, or other commodities," 15 U.S.C. 14 (1958). Anticompetitive practices involving "services," therefore, may escape coverage. In *U.S. v. Investors Diversified Services* (102 F. Supp. 645, D. Minn., 1951), for example, a tie-in sale of loans with insurance was found to be beyond the reach of section 3.

37. See *Jefferson Parish Hospital District No. 2 et al. v. Hyde*, 466 U.S. 2 (1984); *Cargill, Inc. et al. v. Monfort of Colorado, Inc.*, 761 F. 2d 570, reversed by S. Ct., December 9, 1986, No. 85-473; and *Matsushita Electric Industrial Co. Ltd. et al. vs. Zenith Radio Corp., et al.*, 723 F. 2d 288, reversed by S.Ct. on March 26, 1986, No. 83-2004.

38. 394 U.S. para. 495 (1969).

39. 12 U.S.C. 1843 (c)(8) and section 225.4 (b)(2) of the Federal Reserve Board's Regulation Y (12 CFR 225.4 [b](2)).

40. *Ibid.*

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41. See Citicorp (Citishare), *Federal Reserve Bulletin*, vol. 68, p. 505, para. 5112 (1982).
42. BankAmerica-Schwab, *Federal Reserve Bulletin*, vol. 105 p. 112 (1983).
43. 12 U.S.C. 1972-1978.
44. Jefferson Parish Hospital at 12-14; and Fortner I at 509.
45. See note 14.
46. See notes 15 and 16.