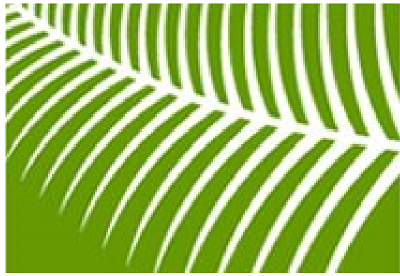

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STAFF PAPER

1985
Banks and banking

Agricultural Experiment Station
Institute of Agriculture
University of Tennessee
P. O. Box 1071
Knoxville, Tennessee 37901-1071

SP-85-01 August, 1985

DEREGULATION OF FINANCIAL INSTITUTIONS: IMPLICATIONS FOR RURAL AREAS*

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*Paper prepared for a symposium entitled "Rural Capital Markets for Nonfarm Business Activity," at the 1985 AAEA Annual Meetings, Iowa State University, Ames, Iowa, August 4-7, 1985.

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E11-1215-00-001-86

Introduction

The financial services industry is in the midst of changes that are altering its institutional structure. These structural changes have potential impacts on rural capital markets and the individuals and industries served by them. This paper describes the changes that are taking place and raises some questions relevant to future discussions and/or research about rural capital markets. The first section provides the historical context for banking regulation. The second section describes the current deregulatory movement from the perspective of institutional innovation and briefly describes the major features of banking deregulation. The third section outlines potential structural changes in the financial services industry. The fourth section discusses specific implications of these changes for rural capital markets and raises questions that should be considered in any future evaluation of changing rural capital markets.

Historical Context

The Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA) ushered in a new era of regulatory reform in the financial services industry. To fully understand the nature of this change, it is necessary to provide some historical context for the current deregulatory movement. The pre-1980 system of banking regulation grew out of the Great Depression and a dedication to eliminating bank failures. This concern with bank failure led to a system of regulations that 1) prohibited interest payments on demand deposits and restricted the rates payable on time deposits (Banking Acts of 1933 and 1935), 2) restricted the scope of allowable activities for commercial banks, e.g., prohibited investment banking (Glass-

Steagall Act of 1935) and 3) established geographical limits to bank expansion (McFadden Act of 1927). The primary motivation behind these regulations was avoiding risk, whether the result of excessive price or product line competition. Any anticompetitive results were of peripheral importance, at best, given the post-Depression concern about the stability of the financial system and, more generally, the overall economy.

Justification for government regulation of industry may arise when private markets fail to achieve an efficient allocation of resources. Such market failure typically results when externalities exist, either positive or negative. Two specific types of externalities are potentially relevant to understanding past banking regulation: public goods externalities and technical externalities.[1] A public goods externality arises when a commodity or service has the characteristics of joint consumption and nonexcludability. There are public goods aspects of banking that may justify government regulation. A smoothly functioning banking system is a necessary ingredient for an efficient economy, providing benefits to economic sectors outside the financial industry. Because of the central role played by the banking system in intermediating capital flows among individuals and regions, failure to provide a stable banking system has repercussions beyond individual agents to society in general. Since banking has characteristics of a public good, the government has a role to play in ensuring the safety and stability of the banking system.

[1]Much of the discussion on the market failure rationale for bank regulation is drawn from Boyd and Kwast. The authors follow Bator in their classification of economic externalities.

The presence of technical externalities, or scale economies, in banking is more difficult to verify. Most researchers have found little evidence of economies of scale in banking that might justify government intervention, as would be the case with "natural monopolies." As a consequence, government regulation of the banking industry cannot be justified on the grounds of protecting the public from the exercise of monopoly power by large firms realizing economies of scale. Indeed, banking regulation has served the opposite purpose of actually limiting competition by restricting entry of new banks into local markets, either from within the state or from outside the state, and of limiting price competition among banking institutions.

Viewing the banking industry from the perspective of the 1930's, the public goods aspects of banking provide a rationale for government regulation. The instability caused by the Depression and Bank Holiday was a fresh reminder of the importance of a stable financial system to overall economic stability. With the Depression as a backdrop, the regulation of the 1930's appears to be justified and the public goods character of the banking industry established.

The present wave of deregulation, however, occurs after a period of relative stability in our financial system and recent innovations that have rapidly changed the nature of financial services. Although the financial services industry retains its public goods character in this new environment, threats to the stability of the system have been reduced by the federal insurance systems and effective government examination of banks' capital adequacy, as well as other aspects of their performance. As a consequence, the anticompetitive aspects of past regulations have begun to assume greater

importance and have been identified by financial institutions as significant operating constraints. Deregulation efforts were consequently directed at reducing these constraints.

Institutional Innovation and Deregulation

The constraints faced by the banking and thrift industries resulted from economic and technological changes which began in the late 1960's, continuing into the 1970's. Specifically, high rates of inflation resulted in market interest rates above the ceilings set on time and savings deposits. This discrepancy led to disintermediation, or a flow of funds out of banks and into new, unregulated financial service institutions, such as money market mutual funds, as depositors sought higher returns on their savings. These new financial services were made possible by advances in computer technology. At the same time that removal of interest rate ceilings appeared justified, thrift institutions would have been adversely affected by such removal, since their assets were primarily locked into long-term, low interest mortgage loans. Yet, disintermediation affected thrifts as it did commercial banks.

Clearly, the economic environment of the early 1970's had changed to such an extent that regulations designed in the post-Depression period, served to place commercial banks and thrift institutions at a competitive disadvantage relative to their nonbank, unregulated financial service counterparts. These nonbank institutions could attract depositors by offering higher interest rates and, thus, enhance their opportunities for profit. The theory of institutional innovation, posited by Davis and North, would suggest that under these circumstances, existing institutions

would adapt or new institutions would evolve to internalize the profits available in the new environment. Davis and North argued that "the possibility of profits that cannot be captured within the existing arrangemental structure...leads to the formation of new (or mutation of old) institutional arrangements" (p. 39). The major components of banking deregulation provided the mechanisms by which institutional innovation in the banking industry could occur. To understand these institutional and/or structural changes, it is necessary to describe the major features of deregulation.

The DIDMCA constitutes the primary legislative package directed toward banking deregulation. According to Cargill and Garcia, the primary objective of the act was:

> to move the financial system toward a more competitive framework ....Greater competition is to be achieved by structural changes in the form of (1) removing interest rate ceilings, (2) widening the sources of funds for financial institutions, and (3) expanding the uses of funds and other powers for financial institutions (p. 46).

The act provides for the phased removal of deposit interest rate ceilings, allowing banks and thrifts to more effectively compete with nonbank institutions, while providing thrifts with an opportunity to reduce their dependence on fixed rate, low interest mortgages. Removal of these interest rate ceilings will restore price competition to the financial services industry, providing benefits to depositors in the form of potentially higher rates on time and demand deposits. Coupled with the removal of rate ceilings was an increase in the types of financial instruments depository institutions could offer. The act authorized expanded use of NOW (negotiable order of withdrawal) accounts and use of share draft accounts by credit unions. More recent establishment of money market accounts has further enhanced the competitive position of banks.

Another feature of the DIDMCA was an expansion in the powers granted to thrift institutions. Thrifts can now offer commercial real estate loans, consumer loans and credit cards in addition to their traditional activity in residential real estate. This expansion was designed to enable thrift institutions to diversify their holdings and reduce their reliance on fixed rate, low interest mortgages. However, the expanded powers have led thrift institutions to incur greater risk and, in some cases, have challenged or taxed their management capabilities.

More recent changes in banking regulation have been less comprehensive than the DIDMCA. Further expansion in banking powers occurred when the Comptroller of the Currency permitted banks to offer discount brokerage, investment advisory and credit life insurance underwriting services. However, most banks favor even greater expansion of their powers into such areas as underwriting municipal revenue bonds and the insurance industry. Another area of regulatory change is interstate banking. Given the national market for most financial services, particularly those offered by nonbanking institutions, most banking institutions favor some type of geographical deregulation. There is pressure to repeal the McFadden Act, thus permitting full scale interstate banking. Although there has not been any action currently by Congress, 11 state legislatures have passed interstate banking laws, some of which permit expansion only within a defined region or with states having reciprocal agreements. At least 20 other states are considering similar legislation (Clayton and Kidwell). The motivation behind the demand for such changes is the desire, on the part of bankers, to share in the profits available in the broader financial services industry, just as nonbank financial institutions are begin-

ning to share in the profits of the banking industry. Only by altering the institutional arrangements or "rules of the game" can banks begin to compete with other financial service institutions in the increasingly broad national financial services industry.

Viewed from the perspective of institutional innovation, deregulation has induced institutional change in two primary ways. First, deregulation allowed existing institutions to change their structures, increasing their ability to compete. Thrifts were able to broaden their lending powers, while banks expanded their offerings of deposit services. New product areas are increasingly available to banks, putting the banking industry on a more competitive footing with such nonbank institutions as Sears, American Express and Merrill Lynch.

Second, deregulation, at least at the state level, is beginning to alter the "rules of the game" regarding the geographical limits of the banking industry. As a result, the structure of the financial services industry is changing, as banks expand beyond state lines via merger or the bank holding company movement. New regional banking entities are being created, thus expanding statewide capital markets and making the concept of an integrated national capital market a reality. This type of movement alters the structure of the financial services industry as a whole, rather than affecting the structure of its individual institutions.

A relevant area for discussion is the nature of structural change in the financial services industry resulting from deregulation. In particular, as these structural changes alter the industry, what impacts will there be on rural capital markets? Will rural farm and nonfarm capital needs be met more efficiently in this new environment? Will new types of financial institu-

tions become predominant in rural areas? The next two sections discuss the structural changes predicted to occur as a consequence of deregulation and the implications of such changes for rural capital markets.

Structural Changes in the Financial Services Industry

Structural change in the financial services industry is expected to occur in several ways. This section describes possible changes that relate to technical efficiency, stability, market concentration and organizational structure within the industry.

Technical Efficiency

In terms of technical efficiency, the deregulation of depository institutions has been promoted as a proefficiency move designed to improve competition between banks and nonbanks, as well as among banks themselves. Cargill and Garcia suggest that the efficiency of the overall financial system should be increased by removing the ceiling on interest rates, thus reducing disintermediation and substituting price for nonprice competition within the industry. They also suggest that a reduction or elimination of the barriers to interstate expansion should improve the efficiency of the flow of funds within the system. If these observations are correct, capital should flow to its highest valued use, whether within the state or outside the state. Deregulation will result in a more technically efficient financial system, where banks are no longer guaranteed a certain profit level. As a consequence, this move toward greater efficiency is predicted to occur at the expense of many existing financial institutions.

Stability

As deregulation moves the financial system toward greater technical efficiency, it moves the system away from a concern with stability. Bank failures should be increasingly common in a deregulated financial marketplace, as suggested by Cargill and Garcia and supported by record high post-Depression bank failure rates in 1984 (70 banks) and 1985 (53 banks through early July) (Klinkerman). Proponents of deregulation argue that the overall financial system is strengthened by deregulation since institutions have greater flexibility to adapt to changing economic conditions. In addition, they argue that weaker institutions are more likely to fail, thereby strengthening the system. Failures have been carefully administered to sustain public confidence in the industry and, with the possible exception of the thrift industry failures in Ohio and Maryland, public confidence has remained high.

However, this perspective on increasing bank failures considers the impact of isolated failures on the national financial system. From the perspective of the local community whose bank has failed, the issue of instability becomes more critical. Most of the bank failures in the past two years have been small, rural banks (Klinkerman). Although their failures generate few ripples in the financial industry at large, the economic and social disruption in the communities can be devastating. In some cases, the bank may be the only financial institution in town, providing the primary source of capital and avenue for savings to local residents. In many cases, the successful buyer for the failed institution is an out-of-town, possibly even out-of-state, bank which eliminates any local control the community may have had over their financial system. The local bank management may be

replaced by management unfamiliar with local financing needs, such as those of agriculture, mining or recreation. On the other hand, this new management may bring a needed change and renewed confidence in the local banking system, stimulating the local economy.

Regardless of the outcome, it is clear that the local or regional impacts of a bank failure are intensified relative to those on the overall system. This potential for increased instability as a result of deregulation raises a question of whether the public interest, at the local or regional level, is served by the process of deregulation. Particularly, the impacts on small, rural areas (or regions) may require special attention. Any policy analysis of deregulation should consider the trade-offs between technical efficiency and the public interest which are inherent in most economic processes.

Market Concentration

Attention has been focused on whether deregulation will result in a more concentrated financial system. In addressing the concentration issue, it is important to distinguish between concentration at the local level and at the national level. Rhoades argues that as geographical barriers are removed, the concentration of banking resources at the national level will increase, probably substantially. However, he does not anticipate any adverse effects of such an increase since the current level of concentration is relatively low. Increases in concentration can also be expected as a result of the movement toward greater efficiency in the financial market. As weaker institutions fail, they will be acquired by or merged into larger institutions, either large independent banks or multibank holding companies. Again, the increase in concentration at the

national level is not expected to result in a situation where monopoly or oligopoly power can be exercised.

At the local level, deregulation, particularly removing geographic barriers, is expected to result in decreased concentration. Many local markets were highly concentrated prior to deregulation. Rhoades observed, however, that "local banking markets showed a persistent decline in concentration and presumably became more competitive between 1966 and 1981" (p. 30). This trend is expected to continue under the influence of current and proposed deregulatory policies. Another factor leading to decreased local market concentration is the increased competition among nonbanks, banks and thrifts. Deregulation promoted such competition by reducing the constraints on banks and thrifts, enabling them to be more effective competitors in the financial services industry.

The net impact of deregulation on national and local market concentration should be positive. At the national level, concentration should increase as less efficient institutions, previously protected by banking regulations, leave the market and their resources are acquired by more efficient firms. Most observers do not predict that concentration would increase beyond some socially optimal level. In local markets, where concentration levels have traditionally been high, deregulation should result in less concentration as competition increases. This result should improve the functioning of local capital markets, as firms are forced to become more efficient or leave the market. However, these arguments do not consider the public interest concerns arising from local bank failures discussed above.

Organizational Structure

A separate issue, but related to market concentration, is the organizational structure of the institutions that will dominate the post-deregulation financial system. Deregulation has served to reduce the distinctions between different types of financial institutions. Thrift institutions now are permitted to provide many of the services traditionally reserved for commercial banks. Banks and thrifts have expanded powers which improve their ability to compete with nonbank institutions. Financial industry linkages with nonfinancial industries, such as insurance and real estate, are being strengthened although how far such linkages will go is undecided as yet.

Removing the artificial restraints on the services each institution can offer should help increase the efficiency of the financial market. Institutions will be free to specialize in providing specific services, such as retail banking discussed below, or to provide a wide range of financial services to their customers. Deregulation has created an environment where the rewards to innovative management are great. In such an environment, no particular organizational type necessarily has a competitive edge, but those institutions willing and able to respond to market forces should prove to be competitive, whether organized as a thrift, banking or nonbanking institution.

For thrift institutions, continued economic survival will require greater emphasis on risk management and planning. The volatility of deregulated interest rates will force thrift managers to use new techniques to reduce interest rate risk, such as variable rate lending. According to Clayton and Verbrugge, these new techniques require "develop-

ment of management information and expertise not required in the sheltered days of the 1970s" (p. 31). Thrift managers will have the opportunity now of determining what type of institution they want to become, whether a savings institution, real estate specialist or full service financial institution. These decisions will require managers to plan in different ways than in a regulated financial marketplace. In spite of such planning, Clayton and Verbrugge predict that concentration is likely to continue. But, they argue that the outlook for survival is positive "for those institutions with a successful operational strategy and the capital base to sustain it" (p. 31).

Focusing now specifically on the banking industry, there are several structural changes likely to result from deregulation. In particular, the importance of banks that have merged into or affiliated with multibank holding companies relative to strictly independent banks may have implications for the performance of financial markets. Another important aspect of organizational structure relates to size, specifically whether small banks can be competitive in an environment increasingly dominated by large financial conglomerates. Finally, the prospects for some banks to specialize in retail banking services may have important implications as one means of ensuring the survival of a variety of institutions within the financial services industry. Each of these issues is discussed below.

First, as deregulation continues, it is likely that the number of independent banks will decline and the number of banks affiliated with multibank holding companies will increase. This trend was set in motion in the 1970's, with the number of multibank holding companies increasing from 86 in 1969 to 361 by the end of 1980. At that time, bank holding companies and their affiliates controlled 74.1 percent of domestic commercial bank assets

(Savage). This trend should continue as troubled financial institutions are acquired by large bank holding companies, as an alternative to liquidation by the Federal Deposit Insurance Corporation (FDIC).

It is not unreasonable to ask whether banks perform differently when organized as independents vs. affiliates of a multibank holding company. Several researchers have suggested important ways that the performance of holding company banks differs from that of primarily independent banks. Lawrence and Talley report that affiliates of bank holding companies typically make more money available to their communities than do independents. They are usually more aggressive, making more loans, particularly installment loans, and holding fewer federal government securities. They usually provide a greater range of services than independent banks. The observations of Lawrence and Talley were generally supported by work done in Virginia (Markley). The affiliate bank was found to behave less conservatively than its independent counterpart in a relatively undiversified, coal mining-based economy. Another apparent benefit of the holding company structure observed in Virginia was the greater human and financial resource base communities had available to them via the affiliate banks. However, independent banks provided greater support to the agricultural sector than did affiliates. This result was supported by similar research in Tennessee.

On the other hand, Mingo argues that a potentially negative aspect of holding company behavior is that these bankers are more profit-oriented than independent bankers, who are likely to be risk-minimizers or size-maximizers. As a consequence, holding company banks are more likely to reinforce the negative aspects of increased concentration by restricting

quantity, i.e., capital availability. The bankers interviewed for the study in Virginia, both independents and affiliates, were found to maximize multiple goals, including profit, rather than strictly profit (Markley). These results appear to conflict with Mingo's observations. However, the results from Virginia were based on a limited case study and may not be representative of banking behavior as a whole. Mingo's results, if accurate, suggest that there may be some anticompetitive results from concurrent increases in concentration at the national level and further increases in bank holding company affiliations.

One other aspect of bank holding company behavior is their potential to improve the efficiency of the flow of funds. Schotland argues that since bank holding companies are able to circumvent many state barriers to bank expansion, credit flows between areas have been eased. Improved capital flows are desirable to the extent that capital-surplus areas have funds they will not use, while capital-deficit areas are unable to acquire funds they need. However, Schotland makes a point that is particularly relevant to concern about deregulation's impact on rural capital markets. He notes that an improved flow of funds may be undesirable if "for sociopolitical reasons, we are unwilling to see disinvestment even though such regions may not be able to compete for funds, on a price basis, with borrowers in other regions" (p. 258).

Research by Barkley and others in Arizona and Colorado suggests that the redistribution of capital occurring under a statewide branching system (similar to the bank holding company structure) compared to a unit banking system (similar to the independent banking structure) is intrarural, moving from slowly growing rural areas to rapidly growing rural areas. In this

case, Schotland's caveat still holds since it may be in the public interest to ensure that some flow of capital be maintained within more depressed rural areas. As a nation, there is historical precedent for such concern about capital availability in depressed regions, such as Appalachia, with our past commitment to funding such agencies as the Appalachian Regional Commission and the Tennessee Valley Authority.

Second, small banks (assets of $50 million or less) dominate the U. S. financial system in terms of numbers. However, large banks may assume increasing importance as the financial services industry becomes more competitive. Also, one might anticipate a relative increase in the number of large banking institutions if recent high failure rates for small banks continue. Large banks have several advantages over small banks, such as larger lending limits, greater range of advisory services for customers, greater diversification of assets and, thus, risks and the ability to compete on a more equal basis with large, nonbank financial entities.

Although there are some clear advantages to a large sized banking institution, there is also evidence that smaller institutions continue to be viable competitors. Clayton and Kidwell point to the success of small banks in both California and New York, in spite of the presence of Bank of America in California, the nation's largest branching network, and the New York City banking giants competing for depositors in New York State. Small banks continue to survive in these states under extremely tough competitive conditions. This experience suggests that, at least at the present time, the nation can support a two-tiered banking structure, composed of very large banks and bank holding companies meeting large-scale national and international capital needs and smaller institutions

serving local or regional capital markets. As regional interstate banking proceeds, a middle tier of regional banking entities may develop as well.

Third, the tiered structure described above suggests different roles for different types or sizes of banks. Heimann predicts that

> an extraordinarily important role will remain for the community bank, for nothing can substitute for the bank run by somebody who knows the community's people. In the United States, we probably will end up with a system of franchise banking in which the large money center banks and regional banks provide services to, and perhaps even have ownership in, the community banks. These will still be run by the local Mr. and Mrs. Jones, but they will secure their support services from the larger institutions...That way a small community bank can compete--not only with the regional bank and Citibank, but with Merrill Lynch or Dean Witter or Shearson-Lehman (p. 39).

By specializing in providing retail services, small, community banks may be able to define their niche in the financial services industry, leaving the wholesale banking market open to larger institutions. Through such specialization, community banks can ensure a continued role in their community's economic development process.

As deregulation proceeds, the financial services industry should become more efficient, relying on price competition to weed out weak, poorly managed institutions. Stability in a macro sense may not be threatened by this process, but individual communities could face serious adjustment problems. Market concentration will likely increase at the macro level, while it decreases at the micro level. However, changes in concentration are not predicted to have any negative impacts on competition. Finally, there will likely be more large banks and bank holding companies in a deregulated market, although small independent banks should be able to compete in most markets. These smaller institutions, however, may be forced to specialize

and become retail banks or franchises of larger institutions in order to maintain a brick and mortar presence in their home communities.

Implications for Rural Capital Markets

Given the range of structural changes anticipated in the industry, what are the implications for rural capital markets? Three specific areas of concern will be discussed: capital availability and cost, range of financial services and the role of financial institutions in economic development.

Capital Availability and Cost

As the efficiency of the national financial market is improved, capital should flow more freely between individuals and between regions in the country. As noted by Schotland, this increased capital mobility may work against rural areas, in general, and depressed rural areas, in particular. Investments in rural areas are likely to have higher transactions costs, due primarily to the high cost of acquiring information about risk and expected rate of return. In addition, rural investments are likely to have a lower expected rate of return, given the greater uncertainty involved in most rural enterprises. The result might be disinvestment in some rural areas as capital seeks its highest return, to the benefit of urban areas or more rapidly growing rural areas (Barkley, Potts and Mellon). It is possible that less capital may be available in rural areas than is required to meet public and private sector capital needs. Determining any constraints on capital availability in rural areas as a result of deregulation is an important public policy need. Specifically, as financial markets are deregulated and geographic barriers removed, how

will rural areas fare in the competition for capital? Will there be a net outflow of savings from rural areas, as institutions with linkages to the national capital market channel capital into more profitable, many times urban or suburban investments? Will certain sectors of the rural economy have more limited access to capital (e.g., agriculture), while other sectors have increased access (e.g., consumer, commercial)? What trade-offs exist between establishment of a more efficient financial market and protection of the public interest inherent in maintaining a stable financial market, even at the micro or rural community level?

A related issue is the cost of capital and financial services in rural areas. The rate of return to rural savers should increase as interest rate ceilings on deposits are removed. New financial services offered by banks, such as money market accounts, as well as the services of financial networks such as Sears, will increase the range of investment opportunities available to rural residents who have typically relied solely on their local bank for financial services. Higher earnings on savings would be anticipated as a result. However, the cost of more traditional services, such as regular checking accounts, is likely to increase. There is some cost to expanding the range of services available to consumers and this cost will likely be met by higher fees for the services provided by financial institutions. Will rural residents end up making higher net payments for services as a result of deregulation? Will a certain minimum or "lifeline" level of services be available to all rural residents at reasonable cost?

Range of Financial Services

As noted above, rural residents should have a wider range of services available to them in a deregulated financial market. Most banks, regardless

of size or organizational structure, will be able to offer the most recent innovations in financial instruments. In addition, as the holding company form of institution expands, rural areas may have improved access to specialized financial services provided by these large institutions, such as municipal bond packaging/financing and investment counseling. These services typically are not found in small, rural, community banks where staff are limited in terms of time and expertise. Research in Wisconsin found a lack of experience among small, rural banks in putting together complex financial packages and tapping nonlocal sources of funds (Taff, Pulver and Staniforth). These results suggest that rural areas may be able to take advantage of the expanded services available in large bank holding companies, perhaps improving their ability to sell local bond issues and make crucial infrastructure investments that could facilitate economic growth. If financial services are expanded in rural areas, will the financial needs of small, nonfarm businesses be met more effectively? Do rural businesses and local governments have the necessary management skills required to fully utilize such services? Does an expansion in the range of services or financial institutions available in rural communities imply a similar expansion in capital availability to these same communities?

Role of Financial Institutions in Economic Development

While the expansion of holding company banks may increase the range of financial services in rural areas, how will the role of financial institutions in the economic development process change? Holding company banks are typically controlled from outside the local area, with major policy decisions being made at company headquarters. As decision making

is removed from the local area, there is a possibility that these banks will take a less active role in a community's economic development process and may be less aware of particular financing needs that may arise in the community. One example relates to agriculture, where policy decisions related to farm lending may be established in metropolitan areas, by people unfamiliar with the unique conditions in agriculture. Such a situation was evident in Virginia (Markley). As rural independent banks fail or are acquired by holding companies, what are the implications for capital availability to various sectors of the local economy?

Another problem can be created if bank holding company policies are based on statewide economic conditions, rather than specific area economic indicators. Rural areas in a state may respond differently to economic stimuli and, as was true in Virginia, may respond more slowly to general economic improvements (Markley). As a result, affiliate banks' policies may be less flexible, making these banks less responsive to specific local economic needs and reducing their potentially positive role in the economic development process.

The benefits brought to a rural area by the affiliate banks in a large holding company system, such as expanded services and expertise and larger lending limits, can stimulate rural economic development. At the same time, the benefits of the local community bank, such as local decision making, knowledge of the local economy and flexibility in adapting bank policies, suggest an important role for these banks in influencing future development. In cases where both banks exist, a complementarity should be created with potentially large benefits to rural areas. Where only one type of bank exists, it is important to identify the potential strengths and weaknesses of

these financial markets. What are the benefits and costs to a rural community of the holding company form of banking organization? The independent banking form? What are the implications for a rural area when one type of banking institution dominates? Will banks continue to be major providers of capital in rural areas or will nonbanking institutions become dominant? What role do these nonbanking institutions play in the process of rural economic development? Can an argument be made for saving the "rural community bank" as has been made for saving the family farm?

Conclusions

Deregulation will result in a substantially changed national financial services industry. The technological basis of many of these changes suggests that financial innovations will reach throughout the country into most rural areas. Most types of financial institutions will compete for deposits on a relatively equal basis, providing similar types of services. It is anticipated that the full range of financial institutions and financial services will be available in most rural communities. The questions that remain, however, relate to the impact of such changes on the rural economy. It is not clear whether these changes will provide net benefits to rural areas and whether all sectors of the rural economy will share equally. As the financial industry becomes more centralized, with larger institutions providing more of the financial services, either directly or through local franchises, the traditional role of the community banker in encouraging local economic development may fall by the wayside. Or, this typically passive role may be replaced by a new breed of financial managers, bringing new ideas and new sources of capital to

bear on the economic problems faced by many rural areas. Future research efforts should be directed at 1) identifying the specific structural changes occurring in rural capital markets as a consequence of deregulation and 2) determining the net impact on rural communities of such innovations. Deregulation provides a challenging new environment for managers of financial institutions, who must adapt to new "rules of the game" in order to succeed. It also presents a challenge to people in rural areas as they turn to a complex, new financial market to meet their increasing capital needs.

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