A Review of the Report of the New York State Superintendent’s Advisory Committee on Financial Reform**

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Introduction

The impetus for the Report of the Superintendent’s Advisory Committee on Financial Reform, (hereafter called the Report), came from delays in implementing the proposals of the President’s Commission on Financial Structure and Regulation (popularly referred to as the Hunt Commission). (1) Like the Hunt Commission Report, the Report is concerned with recommendations and does not purport to be a study commission. Unlike the Hunt Report, the Report does have a vested interest in the dual system. The Report is divided into sections on: general principles; 10 recommendations for action; 5 recommendations for study; and a comparison chart of issues, laws and proposals. (2) The principles section, not unexpectedly, recognizes the primacy of consumer benefits balanced by bank safety requirements, housing needs, fair competition, less regulation and preservation of the dual system of bank regulation/supervision/charter. The terms of trade among these principles are not made explicit nor are the principles themselves unambiguously defined. A brief discussion of each of the Report’s 10 action recommendations in the order in which they appear in the Report follows below.

Report Action Recommendations

1. a. Branching

Accelerated bank demand for additional branches and proximity to the 1976 date when statewide branching takes effect makes branching a lively issue in New York State. The Report recommends:

(1) uniform branching standards among the thrift institutions (mutual savings banks and savings/loan associations) and commercial banks regardless of charter origin (State or Federal) and increased uniformity between Federal and State branching standards;

(2) continued encouragement of branching as an important consumer convenience with concern expressed about impact upon small upstate communities (overbranching); and,

(3) reciprocal interstate banking via holding company acquisitions confined to major cities.

Differentials in branching standards are a viable (and perhaps irritating) facet of the dual system. (3) Presumably one of the virtues of the dual system lies in different factors regulating supervision. It is not clear why an important permissive element of the dual system—setting branching standards—should be voluntarily relinquished. The other branching recommendation, calling for equal branching standards between thrifts and commercial banks, has less justification. In the past, New York State thrift branching regulations have been more stringent than those applying to commercial banks. However, rather than bring them up to par with commercial banks, a good argument can be made that for some situations a thrift branch may be acceptable whereas a commercial bank branch might not and vice versa. (4) Thrifts and commercial banks compete essentially in only two markets—savings and residential mortgages—and often their respective market boundaries are dissimilar. Uniform branching standards may be defensible if the artificial market segmentation separating the two classes of deposit intermediaries was legislated away but the Report does not recommend that course of action. In sum, the Report’s recommendation to establish equal branching standards among all deposit intermediaries in general is not satisfactory.

While the banking industry celebrates branching as synonymous with customer convenience (an obvious social good), it is not clear that continued branching in the traditional manner merits encouragement. Two comments seem appropriate. First, given deposit rate ceilings below market interest rates, branching may be viewed as a competitive alternative to interest rate competition. Second, accelerated bank branching via separate physical buildings in the traditional manner may impose, in the long run, some real costs both upon the industry and the community. The economies of emerging electronic funds transfer systems and public acceptance of low cost branch type facilities at existing retail outlets both question the traditional importance of building separate physical facilities. (5) Whereas the Report does express concern about overbranching in small communities (especially as regards impact of local real estate values/rentals), little attention is paid toward detailing in explicit terms just what are the standards of social welfare involved in branch location approval. Given price setting at the retail level, an overbranched banking community can maintain requisite profit margins quite independent of additional competition. Problems of pre-emptive branching deserve attention but the Report is not helpful here.

Reciprocal interstate banking seems a promising step towards recognizing the ongoing defacto consolidation of the banking industry. But, why should the advantages of banking across state boundaries accrue solely to the denizens of large cities? Are not small cities and large city suburbs entitled to equal advantages? Does the small independent banker have more to fear from a large out of state bank than from a large in-state bank? These problems point towards eventual uniform state banking legislation and the demise of the dual system.

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2 The principles section concentrates on: taxation inequities; mutual thrift conversion to stock form; residential mortgage enactment; and enhancing financial institutions' defense of total financial planning services (will drafting, small trust/estate management) to the less wealthy consumer. The comparison chart, some 35 pages long, includes comparisons on selected issues, laws and proposals from amongst the Report and the earlier Hunt, Treasury and Panama reports on financial structure reform.

3 Federal banking guidelines presently are more liberal than those of New York State. See (5), p. 13.

4 State may argue that branching standards can be dispensed with altogether. (10)
b. Residential Mortgage Loans

The Report recommends liberalizing statutory mortgage lender restrictions and equalizing them among the deposit intermediaries in the following manner:

1. remove aggregate residential mortgage loan limits for thrift institutions;
2. remove specific dollar ceilings on individual conventional mortgages;
3. raise the loan-to-value ratio to 95% for conventional borrowing, co-op apartments and condominium housing; and,
4. extend the 40 year maximum mortgage term to include co-op apartment loans.

These are useful long-run recommendations but unfortunately will have only limited impact on the mortgage market, given the present economic conditions.

c. Legal Mortgage Ceilings

The Report recommends legislation designed to "...replace the present statutory legal interest rate ceiling with a more economically responsive ceiling." A widely held view is that constraining thrifts to a largely residential mortgage asset role together with mortgage rate and deposit rate ceilings has improved the flow of residential mortgages at less than market rates. When comparable open market rates exceed deposit rate and legal mortgage ceilings, the system doesn't work as intended. In New York State, legislative action is required to raise the legal mortgage ceiling and this process has been subject to criticism. Two suggestions that would meet the Report's objective would be:

1. floating the legal rate several percentage points above the relevant open market rate; or
2. granting the State Banking Department discretionary authority to set the legal mortgage ceiling. Either would be satisfactory, in the sense they would be an improvement over the present procedures.4

4Some may favor abandoning legal mortgage ceilings altogether but such ceilings do provide the basis for bringing criminal charges against a sexual lender who coerces or dupes an uninformed borrower. I am indebted to Leonidas Lapidus for bringing this to my attention.

d. Second Mortgage Restrictions

The Report recommends liberalizing second mortgage loan restrictions with broad regulatory authority granted to the State Banking Department. Houses are variable price assets and typically gain in value during periods of rising prices. Presently the banking industry is prohibited from writing second mortgages. Consumers are denied the use of the licensed realtor industry for purposes of raising credit based on the increased equity of their houses. These are useful recommendations.

e. "Leeway" Powers

Commercial bank asset restrictions as regards real property and equity securities date largely from 1930's; presently the latter is prohibited entirely while the former is restricted to a very small amount by way of a "leeway provision." The Report recommends raising the real property "leeway provision" presently applicable to thrift institutions from 1 to 2% of assets (or 20% of capital and retained earnings, whichever is smaller), and extending coverage to commercial banks, but continuing to maintain the prohibition against general equity market investments. Extending "leeway" powers is one means of easing up asset portfolio restrictions on deposit intermediaries. Whereas real property investments involve potential liquidity/safety problems, the appropriate limits for "leeway" are difficult to prescribe. Proposers of a vigorous dual system might be expected to suggest a higher maximum limit, say 5%, but give the State Banking Department broad discretionary power to set the current limit. In this manner, the Department could raise (or lower) the limits in small increments as experience is gained, without requiring legislative approval.

f. Management Accountability for Mutual Institutions

The Report recommends depositors of mutual savings banks be granted annual trustee voting privileges, trustees to be elected by depositors, and terms of office to be staggered. Also, it is recommended that mutual savings bank depositors and savings loan association shareholders be granted financial disclosure from their institutions in a format similar to that made available by commercial banks. These recommendations are clearly in the public interest. They were not part of the Hunt Commission proposals and deserve to be implemented forthwith.5

5These proposals are similar to those made by Benston (4).

g. Thrift Charter Conversion

The Report recommends that State-chartered mutual savings banks should also have the option of Federal charter conversion and Federal chartered savings loan associations should have the option of State charter conversions. Neither of these conversion privileges is presently allowed. In practice, the dual system has been restricted to commercial banks and it is natural for its advocates to propose extension of its benefits to include the thrift institutions as well. The problem of mutual to stock conversion is left unsettled.

h. Diversified Consumer Services for Thrift Institutions

The Report recommends allowing thrift institutions to offer individual checking account services and consumer loans. The latter would be introduced on a phased in basis and limited to 5% of assets. The benefits of these additional powers, the Report claims, are as follows:

1. additional source of consumer loan credit;
2. improved thrift earnings and liquidity; and,
3. more stable source of housing credit.

Perhaps the major distinction of the Hunt Commission report has been to focus public attention upon the complex web of hidden subsidies extended to the housing industry, mostly through the thrift institutions. During periods of rising and continued high interest rates, the present patchwork system, even with massive infusions of Federal support, has not been able to redirect savings flows into residential housing investment at desired aggregate amounts. Furthermore, question has been raised about the continued financial viability of the thrift industry in its present form. The Report does not focus attention upon the subsidy issue, but like the Hunt Commission, does raise the viability issue. Had the Report's recommendations been in effect by 1974, the viability of the thrifts would have been only marginally improved. Higher net returns on the consumer loans (compared to mortgages) that are allowed to aggregate but 5% of assets are not quantitatively large enough to influence thrift earnings strongly.6

6In the early years, start up costs might keep the net differential small or perhaps even negative. Also, given the sizable presence of the savings bank industry in New York State, the potential benefits to consumers, even under the 5% limit, are substantive.

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consumer loan powers. The long run viability of the thrift industry, including the interests of its depositors in obtaining maximum deposit yields, can be best assured by allowing that industry the full deposit intermediary powers presently available to commercial banks.

Even if the Banking Board is committed to preserving the thrift industry for cheap housing credit replete with price ceilings on mortgage and deposits, it is not clear why consumer loans should be limited to 5% of assets in the aggregate for each institution. The commercial bank consumer loan market is not generally characterized as one that includes price competition in its normal operations; in New York City, the rates typically remain at fixed levels for several years at a time.5 Allowing the thrift industry only marginal involvement in the consumer loan market implies only marginal benefits for consumers as well. The interests of broadening credit access for this market need not be inferior to housing credit. Consumers should be allowed to choose the form and relative proportions of credit desired. If the vigor with which the thrift industry competed for deposits in the past decade is any indication, significant consumer benefits could be expected from unfettered thrift competition in the consumer loan market. Shortfalls in housing credit properly deserve the attention of direct Federal subsidiaries. (1)

1. Reserve Requirements

The Report recommends that demand deposit requirements for state chartered nonmember banks also be imposed upon thrifts, where applicable, and a uniform 1% reserve requirement on time/savings deposits for all banks and thrifts in the state. Also, the thrifts would be allowed to count selected short term earnings assets for reserve computation purposes. The Report reaches back to the 1963 Heller Committee recommendations in support of time/savings deposit reserve requirements. While clearly going against the mainstream of reform proposals in advocating such requirements, the modest 1% level recommended suggests a less than enthusiastic endorsement. The Report argues that with proposed expanded consumer loan powers for thrifts, the statutory differentials in time/savings deposit reserve requirements should be removed. The differential can be narrowed in at least 2 ways: (1) raise thrift requirements to present ones for commercial banks; (2) lower requirements for commercial banks but apply them also to thrifts; and (3) lower non-member state chartered banks, lower the requirements for non-member banks and apply them for the state chartered thrifits. The first proposal is presently beyond the abilities of the thrifts. The second, proposed in the Report, depends on Federal legislation and has uncertain prospects. As for the last proposal, the state does have the power under the dual system to differentiate time/savings deposit reserve requirements; presumably a vigorous dual system implies differential requirements. The 1% reserve requirement suggested in the Report contrasts sharply with the present 3-5% requirements; the state can implement the 1% differential on state chartered commercial banks and thrifts, or better still, merely lower state chartered commercial bank requirements to modest levels.

2. Deposit Interest Rate Ceilings

The Report recommends: (1) allow commercial banks with asset/liability mix similar to thrift institutions the same rate ceilings as imposed for thrifts; (2) phase out ceiling differentials between commercial banks and thrifts; and, (3) place deposit rate ceilings on standby authority to be used when disintermediation threatens the industry.

The first recommendation reflects the problem of maintaining competitive equality amongst deposit intermediaries competing in similar markets but under a different regulatory format. The 1/4 percent differential presently in effect obscures a very real difference—most thrifts credit low balance accounts' interest on a day of deposit to day of withdrawal basis, whereas commercial banks, often the smaller ones, merely credit on the lowest daily balance during the quarter.6 As for the third recommendation, it has been amply demonstrated that sophisticated savers make and run around the deposit regulations in the equity/debt markets, while the relatively small savers are penalized. Deposit rate ceilings are an ineffective form of price control and have inequitable transfer costs; they should be removed altogether.

Concluding Comments

It is widely recognized, at least among academic economists, that the present regulatory structure of deposit intermediaries is suboptimal. If we were to start anew with a clean slate, the present system would hardly expected to be put forth as a candidate. While we may not be able to post an optimal regulatory structure for the industry, most observers would likely list, as a minimum, the following concerns in their agenda for bank regulation reform: (1) artificial market segmentation (branching/limitations, market restrictions, price ceilings, product exclusions); (2) impact of unprecedented technological innovation (including EFT promising to negate the vested uniqueness of checking accounts to a minor role); (3) disintermediation problems of thrift institutions constrained to a subudy-price housing credit role and disintermediation between deposit intermediaries totally and the credit market.

Home mortgage or methods of paying interest are in vogue. A useful discussion is found in "How to Pick the Best Savings Account" Consumer Reports, Feb. 1975, pp. 90-97.

6Previous work in this rapidly growing literature includes (2), (3), (4), (5), (7), (8), (9), (10).
"If New York, the nation’s most important banking center, cannot continue to play a major role in regulating its own banking system, then the continued existence of a flexible and responsive system of dual banking regulation is in serious jeopardy." \(^{12}\)

References


Leonard Lapidus et al., Public Policy Towards Mutual Savings Banks in New York State: Proposals for Change (New York: Federal Reserve Bank, New York State Banking Department, 1974).


12(6), p. 42. This is the concluding paragraph in the action recommendation portion of the Report.

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Educational Expenditures and School Enrollments in Less-Developed Countries: A Simultaneous-Equation Model

by C. R. Winograd

Abstract

The purpose of this paper is to identify and measure the determinants of educational expenditure, enrollments, and outlays per pupil for a cross-section of LDCs (less developed countries) and to trace the interconnections among these variables. A simultaneous-equation model is developed, and then tested by two-stage least-squares regression procedures. In their structural form the regression results establish the statistical validity of the model; in their reduced form they gauge the full impact of each variable within the simultaneous system. The findings include specific estimates of the tradeoffs between enrollment and outlays per pupil at the various educational levels. It seems clear that the African nations tend to place major emphasis on primary education, the Asian countries on secondary schooling, and Latin America on higher education.

A large and growing body of economic literature is concerned with the quantitative and qualitative deficiencies of education in less-developed countries (e.g., Anderson and Bowmann, 1965; Coombs and Hallak, 1972; Haberian and Myers, 1964; Robinson and Vesay, 1966; and UNESCU, 1968). \(^{1}\) Little attention has been given, however, to the determinants of the amount of education actually provided, despite great variation among the LDCs in this respect. Such variations point to the need for, and the technical feasibility of, cross-sectional analysis.

Among the cross-sectional studies that have been made, some are based on simple correla-
tions between an education variable (enrollment and expenditure) and an index of economic development, such as per capita income, [Bowman and Anderson, 1968; Haberian and Myers, 1964]. In others, multiple-regression equations are used, but the number of explanatory variables is extremely limited. [Piot and Deauvais, 1966; Chesney, Elkington, and Sors, 1970; Edding and Berlesteher, 1969]. In all cases, these models take the single-equation form, which means that total educational spending and enrollments are treated as unrelated phenomena. This separation is not only unrealistic, but also results in the neglect of the determinants of expenditure per pupil, a crucial dimension when viewed either as the unit cost

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1The listed references comprise only a small sample of a vast accumulation of literature on various aspects of this topic. For a partial bibliography, see Illias [1970].