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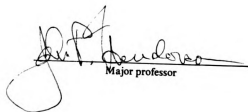
THE TRANSFORMATION OF CREDIT UNIONS
IN THE UNITED STATES

presented by

Edward Michael Eloian

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THE TRANSFORMATION OF CREDIT UNIONS
IN THE UNITED STATES

by

Edward Michael Eloian

A DISSERTATION

Submitted to
Michigan State University
in partial fulfillment of the requirements
for the degree of

DOCTOR OF PHILOSOPHY

Department of Economics

1986

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ABSTRACT

THE TRANSFORMATION OF CREDIT UNIONS IN THE UNITED STATES

By

Edward M. Eloian

This dissertation examines the historical emergence, development, and subsequent transformation of credit unions in the United States. It posits the argument that recent economic and financial market events have caused credit unions to become an institution fundamentally different from that which they were in the past. It differs from other credit union studies in that it specifically focuses upon credit union development in terms of membership type, i.e., common bond.

The study traces the general pattern of U.S. economic growth and shows the fundamental manner in which the growth process motivated the emergence and evolution of various financial depositories in conjunction with major structural changes in the nature of the economy. It shows how the historical emergence of industrialization and urbanization and the consequent creation of a class of wage-earners motivated the growth of a mass consumer goods market. In turn, it is shown how this market leads to the establishment of a consumers financial services market. The emergence of credit unions in the United States is shown to be a function of these same forces. In addition, it examines the subjective elements, i.e., the pioneers of the credit union industry, to ascertain the motivations which drove them to es-

tablish credit unions. It contrasts the subjective forces with the objective factors to understand more fully the historical *raison d'etre* behind the emergence of the credit union form of financial service delivery.

It conceptualizes the development of credit unions in terms of the dual influence of general economic conditions and financial market developments. It illustrates in a historical sense how favorable post World War II economic conditions led credit unions to adopt certain operational postures. Moreover, it shows the extent to which credit unions were forced these postures as a result of structural changes in the U.S. economy which occurred during the late 1970s and early 1980s. This study also shows the extent which competitive financial market conditions have forced credit unions out of their once secure markets and into competition for their own members' business. It is shown how the combined effects of their aforementioned events have forced a quantitative shift in credit union assets and liabilities.

The adjustments made by credit union regulatory authorities and credit union management are also examined. The changes in credit union regulations, both practically and philosophically, are examined to comprehend the scope of the transformation which has occurred. The adjustments made by credit union management to cope with their new deregulated environment are examined to put into focus the extent of the transformation with respect to internal credit union operations and financial performance.

The methods and procedures used in gathering data included the research of published credit union data sources. In many instances, the

paucity of data necessitated a qualitative analysis. Quantitative material on credit union growth and development stems from research of Annual Federal Credit Union Reports over the 1936 to 1985 period. Historical data on economic growth and development and evolution in financial markets was gathered from secondary sources.

The dissertation concludes that credit unions, as financial institutions, must operate under extremely competitive conditions. As a result, credit unions no longer can choose to remain aloof of these conditions. Also, credit unions can no longer take for granted structure of the U.S. economy. They must be aware of the changing composition of U.S. industry and adjust the membership bases accordingly. Finally, to remain competitive, credit unions must adjust their management styles to accomodate these changing economic and financial market conditions.

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Special thanks are extended to Dr. Rowena Pecchenino and Dr. Nancy Jianakoplos for their gracious assistance in this work. A very warm thank you is extended to Dr. Warren Sammuels, who has stayed with me through some very turbulent times. His encouragement provided me with that little extra it took to make this dissertation a reality. His guidance and friendship will always be appreciated. Finally, I would like to extend to Dr. John Henderson a very gracious and sincere thank you. Dr. Henderson has known me since I came to M.S.U. and in all those years he has truly been one of my closest friends. It is indeed true that if were not for his compassion, generosity, and all-around warm heartedness, I would not be writting this note of thanks to anyone. Simple words cannot express the extent of my gratitude, therefore, let me just simply say, Thank You for everything you have done for me.

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CHAPTER ONE

Introduction

This dissertation posits the argument that the recent economic and financial market developments have transformed the nature of the credit union industry within the larger context of the historical economic development of the United States. By tracing the historical pattern of U.S. economic growth, this dissertation outlines the manner in which economic growth has motivated financial institutions to evolve in conjunction with the major stages of U.S. economic development. This analysis details how industrial development and the birth of the working class led to the emergence of a mass market for consumption goods which in turn led to the establishment of a consumer financial services market. Credit unions were one form which financial institutions assumed in this market. Specifically, the extent to which credit union growth and development has been influenced by general economic trends will be highlighted. On the basis of this analysis, this thesis will further examine the credit union industry's response to the economic dislocations of the late 1970s/early 1980s and the resultant structural adjustments in credit union operations. An analysis of changes in balance sheet items, such as shares, loans, investments, interest income, and interest expense, will show how credit union operational management has so fundamentally changed as to only partially resemble past practices.

The change in credit union management practices and the new emphasis on profitability and operational/economic efficiency will be reviewed in light of the fact that credit unions, as financial institutions, have now separated their economic and financial goals from the economic and

financial goals of its membership. Many aspects of credit union operations, from services offered and prices charged (including the introduction of service charges) to the philosophical and practical orientation between the institution and its membership have changed sufficiently to warrant this study of credit unions.

Specifically, this dissertation supports the contention that transformation of credit unions is characterized by several factors. First, the macroeconomic developments and factors which influenced the financial and economic well being of credit union members. Such developments and factors include employment patterns, industrial trends, income growth, consumer prices, consumer spending, consumer savings, and consumer borrowing trends. The analysis facilitates an understanding of the historical relationship between these factors and the growth and development of credit unions in aggregate and according to common bond type. To adequately comprehend credit union growth, those factors which have influenced credit union operations throughout the twentieth century will be reviewed. In so doing, an analytical basis will be formed from which to evaluate changes in credit union financial performance and managerial practices during the late 1970s and early 1980s.

Second, the impact of changing financial market conditions on credit unions will be reviewed. This discussion analyzes the trends in interest rates, inflation rates, bank and thrift competition, and general market conditions to assess their historical impact on credit unions. This study also examines the parallels in the development of price and product lines between credit unions and other financial institutions. It will be shown

that credit union balance sheet items have altered to such an extent that they resemble the balance sheet items of other financial institutions. Finally, this study will assess the extent to which credit unions funds, both inflows and outflows, have become interest-rate sensitive and to what extent this exposure has impacted credit unions.

Third, changing economic conditions have caused significant changes to internal credit union management. Specifically, the recent techniques and methods adopted by credit unions in an effort to adjust internal operations to accommodate the newly evolved risks in financial intermediation will be discussed. Accordingly, this segment of the study will investigate the manner in which credit unions have dealt with the following:

1. Interest Rate Risk. The extent and manner in which credit unions have minimized their exposure to interest rate fluctuations.
2. Credit Risk. The extent and manner in which credit unions have come to rely on objective measures of lending to members versus investing in market securities.
3. Managerial Risk. The extent and manner in which credit unions have overcome past management practices.
4. Liquidity Risk. The extent and manner in which credit unions have minimized the possibility of not meeting member demand for funds.
5. Economic Risk. The extent and manner in which credit unions have adjusted operations to offset the adverse impacts of cyclical economic factors.

These five risk factors together define the spectrum in which credit union management must operate and provide the proper decision making balance so vital to a credit union's survival in today's uncertain economic environment.

This dissertation specifically differs from other studies on credit unions in so far as it concentrates primarily upon the evolution of credit unions by common bond type. While most credit union studies have either examined credit unions according to asset size or in aggregate development, there is very little in terms of analysis by common bond type. This is especially important in light of the fact that the development of credit unions on the basis of common bond type is rapidly changing and is transforming the entire credit union industry structure. (1)

An Operational Definition

Credit unions are cooperative, nonprofit consumer saving and lending institutions. As cooperatives, they are owned entirely by their members. As financial intermediaries (see Appendix A), they provide members relatively risk free, interest earning deposit accounts for their savings. Using these same funds, credit unions supply relatively low cost consumer credit to members. Unlike consumer or producer cooperatives, credit union members are both the primary suppliers of credit union liabilities (member savings) and the primary demanders of credit union assets (member loans). Thus, credit union's members comprise the scope of a credit union's market.

Historically, credit unions have provided an institutional basis whereby members, through a pooling of their financial resources, could buttress their financial security. In the past, members have exercised direct control over credit union operations, as credit unions were once a very personal, altruistic institution, whose primary objectives as a financial institution were in support of the financial and economic

objectives of its membership. Consequently, as financial institutions, credit unions had no operational objectives independent of its membership.

This relationship, however, has been dramatically altered, as credit unions, in response to changing economic conditions, have shifted their operational posture toward a more objective relationship with its membership. Correspondingly, direct membership participation has diminished and professional managers have gained an increasing degree of responsibility for credit union operations. This transformation has occurred primarily because of the credit union's response to economic events since the early 1970s. Specifically, the effects of accelerating inflation, unemployment, and interest rate volatility on credit unions compelled them to assign a priority to the relationship between economic conditions and credit union financial performance. Correspondingly, credit union management has moved increasingly toward an emphasis on increased operational efficiency. (2)

Before elaborating further, essential background material concerning the current internal organization, operation, and industry regulation must be introduced. This information will facilitate an understanding of the extent in which recent economic events have impacted credit unions.

The Common Bond

Credit unions are restricted to serving the consumer financial service market, and within this restriction, they are limited to serving groups with a given common bond, i.e., an identifiable set of common

characteristics. This concept functionally served to reduce the cost of gathering credit information and to hold loan losses to a minimum. However, by restricting the pool of consumers from which to draw, credit unions were forced to accept a limitation, or upper bound to their membership base. In conjunction with the 1979-1982 economic recession, this restriction caused severe hardships, even liquidation, for many credit unions, and led to several significant changes in the structure of the credit union industry.

The three principal identifiable membership types which serve as the structural outline of the credit union common bond are:

1. Occupational, wherein everyone in a group either shares a common employer or engages in the same type of work but for a different employer. In the past, these credit unions were generally subsidized by sponsoring firms.
2. Residential, wherein membership is limited to people living in the same geographical region (i.e, community, city, county).
3. Associational, wherein membership is limited to fraternal organizations, labor unions, churches, or lodges.

Statistically, the occupational common bond consists of 79 percent of all credit unions; with 16 percent of all credit unions serving association members; and 5 percent of credit unions being residential/geographic based. In recent years, regulatory authorities have relaxed the credit union common bond constraint to accommodate a new emphasis on credit union growth and stability. This new attitude represents a significant alteration in the philosophy of credit union regulation and supervision.

To become a credit union member an individual must fall within the credit union's field of membership (common bond) and must purchase an initial share in the credit union, generally \$5 or \$10. As credit union members, individuals are generally entitled to avail themselves of the services offered. (3) Every credit union is governed by a board of directors who are elected from the general membership. The board of directors establish the credit union's investment, lending, saving, and general operational policies. Since cooperative principles stipulate that members should pool their labor in addition to their funds, board members, except for the treasurer, do not receive payment for their services. (4) In addition, regardless of the size of a member's savings, each member has the explicit right to vote and to hold a credit union office. Thus, through the democratic process, credit union members have the capacity to effect credit union operations and policy.

Sources and Uses of Funds

Credit unions obtain the bulk of their funds from the membership. To attract these funds, credit unions offer members a variety of savings plans, including share accounts, share certificates, share draft accounts, various types of special club accounts such as Christmas club accounts, and tax sheltered individual retirement accounts.

The share account is the basic credit union savings instrument and is analogous to a passbook savings account offered by other depository institutions. The financial return of a share account is referred to as a dividend and is treated as interest from an individual income tax liability

perspective. Share certificates are comparable to the money market certificates offered by commercial banks and thrift institutions. Technically, these funds are borrowed from the members and are therefore classified as notes payable on the credit union balance sheet.

Share drafts are third party transfer instruments or transaction accounts similar to checking accounts. Share drafts differ from the more conventional checking accounts as they are interest bearing and truncated. Truncation is a processing function whereby an individual member retains a draft duplicate as a record of his/her transaction, while the credit union holds a micro film copy, with the original draft being destroyed. Conventional checking involves the return of the cancelled check to the originator.

Credit unions also offer long term individual retirement accounts (IRAs), and have recently been granted authority to offer self-directed IRAs. Self-direct IRAs differ from the standard type of IRA in that members possess the option to transfer an amount of funds from their credit union account into one or more equity investments such as stocks, bonds, and/or mutual funds.

In some cases, credit unions can accept deposits from other credit unions, corporate central credit unions (the credit/investment institution for credit unions), and/or public/private entities. In addition, credit unions have several options for borrowing funds, which include their corporate central credit unions, other credit unions, and, in some instances, non-members. Credit unions, under certain conditions, are also

permitted to borrow from the National Credit Union Administration's Central Liquidity Facility.

Credit union assets are comprised primarily of consumer loans. A wide variety of open and close-end, secured and unsecured loan plans are offered to members. Traditionally, installment loans have been the mainstay of the credit union loan portfolio, the bulk of which have been granted to members for the purchase of automobiles. (5) Credit unions are also empowered to make real estate, home improvement, and member business loans. Generally, credit unions charge different interest rates for these different types of loans. Over the last few years variable rate loan programs have appeared as credit unions have attempted to stabilize the spread (profit margin) between income from loans and dividends paid on deposit accounts.

The other earning assets of a credit union are investments. Investments can include both long and short term U.S. government securities, loans to other credit unions, certain types of federally insured deposit accounts at banks and/or savings and loans, and other types of low risk investments. However, credit unions are prohibited from investing in high-risk securities such as common stock. (6)

Industry Regulation

Like other financial depository institutions, credit unions are chartered under federal law or under any one of forty-six state laws. Only Alaska, Delaware, South Dakota, and Wyoming do not provide for state-chartered credit unions. Under state laws, the power to charter,

examine, and supervise credit unions resides with those agencies which also regulate state chartered commercial banks and thrift institutions.

At the national level, the Federal Credit Union Act of 1934 permits credit unions to be federally chartered in every state. The federal regulation of credit unions has resided in a series of federal agencies since 1934. Chronologically, these agencies are listed below:

1. The Farm Credit Administration, 1934-1942,
2. The Federal Deposit Insurance Corporation, 1942-1948,
3. The Federal Security Agency, 1948-1953,
4. The Bureau of Federal Credit Unions, of the Department of Health Education and Welfare, 1952-1970.

In 1970, the U.S. Congress created the National Credit Union Administration (NCUA) as the independent agency to regulate federal chartered credit unions. (7) Thus, to the present, the NCUA is responsible for chartering, examining, and supervising all federal credit unions and most federally insured state chartered credit unions through its role as "trustee" of the National Credit Union Share Insurance Fund.

As an independent agency, the NCUA is financed by its (supervisory and examination fees) of credit unions under its jurisdiction. The agency is directed by a three-person board appointed by the President of the United States. The board, which serves six year terms, governs six regional offices, a central office with seven divisions and manages a Central Liquidity Facility. The NCUA board has also assisted groups to organize other federal credit unions.

Federal credit unions are exempted from paying taxes on their income or financial assets by federal, state, or local government. However, they do pay taxes on real property such as land or buildings. State laws regarding the taxation of state-chartered credit unions vary widely. Some states conform to the Federal Credit Union Act and do not tax state chartered credit unions; while other states tax credit unions in a manner similar to mutual savings banks and savings and loan associations. (8)

Recent Developments

Throughout their history in the United States, credit union's operational and managerial practices have been predetermined by a rigid regulatory structure. Within this structure, however, credit unions have been virtually assured of a captive market, as they encountered little direct competition from other financial institutions. Consequently, from the management of their financial assets and liabilities to operational considerations, credit unions were a very simple financial depository institution.

The simplicity of a credit union is reflected in the fact that over most of the post-war period they operated a mere five-item balance sheet: shares, borrowings, and net worth on the liability side; and installment loans and low-risk investment securities on the asset side. Interest rate levels on both sides of the balance sheet were set in compliance with regulatory ceilings. Generally, share accounts paid one-quarter to one percent more than banks paid on their passbook savings accounts while loan interest rates reached a maximum of 1 percent per month on the unpaid

balances (i.e., a maximum of 12 percent annually). This spread assured credit unions of a profitable return on their assets throughout most of the post World War II period.

Credit union growth and development during the post World War II period can be attributed to the following factors: (9)

1. U.S. economic growth and consumer market expansion produced a constant demand for consumer credit. Thus, credit unions benefited from an economic environment that facilitated a stable turnover of assets at favorable rates of return.
2. Increasing personal income levels and relatively low unemployment rates made these earning assets (loans) relatively risk free with respect to loan delinquency and/or default by members.
3. Moderate inflation rates and a consistent U.S. economic policy kept interest rates generally stable, allowing credit unions to operate without much concern for the general composition of their assets and liabilities.
4. Interest rate stability enabled the individual credit union to attract consumer savings.

By 1975, the disappearance of economic stability initiated the final dissolution of the traditional credit union industry and induced the transformation into the current industry structure. The first of the aforementioned factors to vanish was the stability of inflation and interest rates. Interest rate volatility became problematic in the mid-1960s, but it was not until the early to mid 1970s that unprecedented high and volatile interest rates began to negatively impact credit unions. Such interest rate volatility produced a serious mismatch between the term structures of a credit union's assets and its liabilities, creating both an earnings problem and liquidity pressures. (10)

Whereas in the past, credit unions paid little attention to matching term structures, they quickly learned that a volatile interest rate environment can adversely impact financial performance through middle to long-term loans which are financed with short-term interest sensitive funds. As a result, credit unions exhibited an increasing reliance upon more modern methods and techniques of asset/liability management. As this occurred, credit union operations were increasingly viewed within the context of the theories and principles of modern economic analysis. (11)

The second factor to disappear was the historical relationship between credit unions and financial markets. This change occurred as a result of financial industry responses to changing economic conditions and the restructuring of the regulatory environment. Financial industry responses to the new changing interest rate environment took the form of aggressive competition for household savings. Short-term, high-yield money market funds became more appealing to the credit union membership than low yield credit union accounts. In spite of the fact that money market funds were uninsured, their liquidity and relatively higher yields outweighed the lower risks associated with deposits guaranteed by the federal government. Nondepository financial institutions also began offering an expanded array of consumer deposit and credit instruments which legally evaded prevailing regulatory restrictions. The success of such financial products led to a new attitude with respect to regulation of financial depositories and ultimately to the passage of the Depository Institution Deregulation and Monetary Control Act of 1980. This legislation empowered both regulatory authorities and financial institutions with sufficient flexibility to quickly respond to changing market conditions. The outcome of regulatory

changes in the financial industry has been the introduction of both price and product competition in credit union assets and liabilities. (12)

Finally, as a result of the economic decline of American industry, credit unions strength was put to the test. In 1979, the U.S economy suffered from a severe structural dislocation as the manufacturing sector was derailed into a serious recession. Many firms layed off large numbers of workers, while other firms ceased operations altogether. The net effect of this situation hit the heart of the credit union industry, the membership. Credit unions, especially those with occupational charters, were faced with large numbers of unemployed members. Unlike the period of the 1930s when credit unions grew in spite of the depression, this period of economic turmoil found credit union liquidations and mergers reaching unprecedented heights. As a result, credit unions were forced into the realization that their survival as a financial institution was predicated on a relatively prosperous membership base and more sophisticated financial and operational management posture.

The NCUA responded to this condition by authorizing expanded fields of membership and widening market horizons to enable credit unions to offset existent membership losses. In doing so, the NCUA forced credit unions to become more sensitive to changes in the economy by adjusting their internal operations to coincide with prevailing market conditions. Thus, the NCUA introduced an entirely new concept into credit union management, and as a result, credit unions found themselves placed directly into the mainstream of financial market competition. (13)

To summarize, in less than a decade, credit unions went from a market environment in which they encountered little competition to one in which they must operate under extremely competitive circumstances. Consequently, credit unions can no longer afford to ignore the financial markets in which they reside nor the general economic conditions which surround them. To the extent that credit unions no longer respond directly to the financial and economic needs of their membership, credit unions have been forced to change to such an extent that they have ceased to be the institution they once were.

Footnotes

(1) Thomas F. Cargill "Recent Research on Credit Unions: A Survey," Journal of Economics and Business, Winter 1977.

(2) Beginning in the 1980s, credit unions have been introduced to a number of analytical and operational tools. For example, the The Credit Union National Association has recently published a new Functional Costing Manual, which is a methodological outline for analyzing the expenses and revenues by function in terms of per unit costs. The intent of this manual is to provide credit unions with a method to efficiently price its services. Credit Union National Association also offers courses in financial asset-liability management. Although credit unions have been offered financial management courses for some time, only recently have they been introduced to the more advanced concepts such as Gap and Duration Analysis. Finally, credit unions have been introduced to the concept of profitability. In the past, credit unions did not generally focus on profit making. However, over the last five years (1980s), the need to maintain adequate profitability has become the watchword of the industry.

(3) Because credit unions of the past were not profit maximizers, it was not uncommon for a credit union to assist a member without great concern for the member's financial condition. Indeed, credit union advocates would often make it a point to discuss how a given credit union came to the aid of a member who was in financial distress. Moreover, members were treated more or less equally, regardless of the amount of funds they held in the credit union. Presently, however, credit unions have increasingly delineated members according to such criteria as to the extent to which a member is a credit risk, and/or whether the member's salary is large enough to take out a loan. In some cases, members are treated differently depending upon the amount of savings held in the credit union. Members with relatively high savings balances may pay no service fees, whereas members with low balances will have to pay for services rendered.

(4) Recently there has been debate concerning the pros and cons of board compensation. The "modernists" take the position that monetary compensation for board members will provide the necessary incentive to do a better than average job setting credit union policies. The "traditionalists" argue that monetary compensation for board members would destroy the spirit of credit unionism, i.e., volunteerism, people helping other people to attain financial security. For a serious debate on compensation for volunteers see "Pay for Volunteers," Credit Union Magazine, (Credit Union National Association), February 1983.

(5) Traditionally, automobile loans have been a major portion of the credit union loan portfolios. In recent years, however, aggressive tactics on the part of automobile finance companies have increased their share of the auto loan market. As a result, credit unions must competitively challenge the finance companies or shift their loan portfolios into new areas of lending. Pator Bator's, "Road Under Repair", Michigan Credit Union League, 1986, is an extremely insightful analysis of the auto lending environment currently confronting credit unions.

(6) For more on credit union investment options see, "An Investment Guide For Michigan Credit Unions", Michigan Credit Union League, December 1985.

(7) For a short history of the credit union industry regulation, see Donald J. Melvin, Raymond N. Davis and Gerald C. Fischer, Credit Unions and the Credit Union Industry, (New York Institute of Finance, 1977)

(8) Credit Union National Association's, Comparative Digest of Credit Union Acts, (Credit Union National Association), provides a detailed analysis of credit union legislation.

(9) Douglas K. Pearce writes a very insightful analysis of recent credit union trends. "Recent Developments in the Credit Union Industry," Economic Review, (Federal Reserve Bank of Kansas City), June 1984. See also, "Credit Union Structure, Growth, and Regulatory Problems," Harold Black and Robert H. Dugger, Journal of Finance, May 1981.

(10) A good interpretation of the mismatch which occurred between credit union assets and liabilities is in Bob Vonder Ohe "Deregulation," Impact, (CUNA Service Group, INC.), March/April 1982.

(11) A recent attempt at analyzing credit unions with the use of modern economic theory is "Credit Unions: The Economic Theory of a Credit Union," Donald J. Smith, Thomas F. Cargill, and Robert A. Meyer, Journal of Finance, May 1981. A earlier study was that of Mark Flannery, "An Economic Evaluation of Credit Unions," Federal Reserve Bank of Boston, 1972.

(12) Price and product competition is discussed in G. G. Heaton and C. R. Dunham "The Growing Competitiveness of Credit Unions," New England Economic Review, May/June 1985.

(13) The National Credit Union Association provides an analysis of the economic decline of American manufacturing and its impact on credit union viability. See the "NCUA 1984 Annual Report," National Credit Union Administration.

CHAPTER TWO

The Origins and Development of Financial Depositories In the United States

During the course on the nineteenth century the United States developed from a colonial economy, tied to the economy of Britain, into an industrial economy, which was mainly self-sufficient given the natural resource base of the United States. As this process unfolded, there were several periods in which structural change and fundamental alterations in the economy caused significant changes in American socio-economic relations. (As used here, the concept of structural change refers to changes in the economy which occur as a result of the emergence of new forms of production and consumption.) In general, these structural alterations in the organization of the economy provided impetus to the historical emergence and subsequent growth and development of various financial institutions. (1)

In the early nineteenth century, capital derived from commercial activities provided much of the financial resources necessary to finance internal economic development. The developmental process gave rise to a transportation network and to urban-industrial growth, which together defined a new economic structure. The construction of inexpensive, relatively rapid forms of transportation supported a freer flow of commodities and encouraged the expansion of internal domestic trade. Urbanization and rapid population growth, the consequence of natural population growth and immigration, provided a growing source of demand for producer goods and later for consumption goods. Production for a wider, expanding market, however, rendered artisan manufacturing and small scale

agriculture obsolete, as these methods of production could not efficiently meet the output requirements of an expanding market. In their stead, the industrial system appeared, first in textile production during the early nineteenth century.

The hallmark of the nineteenth century was the progressive improvement and extension of industry into other spheres of production which prompted a growing domestic market and permitted a regional division of labor. The spread of this new form of production became more marked following the Civil War and accelerated in the late nineteenth century. As a result, out of a nation of small farmers, craftsmen, and merchant traders, an economy dominated by industrial production and mass consumption evolved by the beginning of the twentieth century.

Each stage of this process produced demands for credit (i.e., financial capital) to finance the newly emerging forms of economic activity. As a result, different types of financial institutions emerged that addressed these changing patterns of demand for business credit and, at a later date, consumer credit. These financial institutions reflected and corresponded to the needs of definite stages of economic growth. By providing the necessary credit to carry on new types of economic activity, the newly emergent financial institutions facilitated the economic development process and provided a means to further economic growth.

This chapter sketches the development process by illustrating, in a general manner, how the process of American economic development induced the emergence of different types of financial institutions. Since the

purpose of this chapter is to provide a general understanding between economic development and the emergence of credit unions during the early twentieth century, it focuses specifically on the emergence of commercial banks and thrift institutions, which were the first financial depositories to appear in the United States.

The Colonial Economy

In the seventeenth and eighteenth centuries, British colonial policy was designed to support the extension of nascent English capitalism. To achieve their goal, the British developed forms of economic policy, such as tariffs, subsidies, and embargoes, that were generally and, in some cases, specifically intended to extend as well as to defend British economic/colonial interests abroad. This not only provided a resource base for British industry but also indirectly ensured a favorable balance of trade.

The American colonies fit this scheme by providing a major market for British exports as well as an important source of imports to be consumed in Britain or to be re-exported to Europe. Thus, the pattern of American colonial production reflected the demand for numerous goods from various spheres of influence within the British Empire. In accordance with such demand, the colonial American economy was based on agricultural production for export to Europe, on shipbuilding, shipping, and other commercial related activities. (2)

Fishing, shipping, and shipbuilding were dominant in New England, whose climate and soil did not produce an agricultural surplus large enough for export. In the middle colonies, temperate weather and excellent river transportation provided favorable conditions for the expansion of wheat farming. The surpluses of grain and meat produced by this region were exported to Europe and New England. The bulk of American exports--tobacco, rice, and indigo--were produced on the plantations and farms of the South. Since British economic policy essentially restricted colonial enterprise to agriculture, shipping, and shipbuilding, the production of manufactured goods was, for the most part, non-existent in the colonies. (3)

These commercial undertakings required continuous financing. In agriculture, for example, credit was needed to acquire labor (which, because of labor shortages, had to be imported in one form or another), to market the cash crop, to buy equipment, and/or to purchase some consumer goods. Shipping and shipbuilding required seasonal, short-term credit to finance voyages and to maintain inventories. British capital provided the major, yet nearly always inadequate source of financing for colonists, which led to the development of local credit facilities known as colonial loan offices. These offices extended short-term commercial loans and issued their own forms of currency. It was from these institutions that the practice of commercial banking in the United States emerged. (4)

In Europe, most banks were formed by wealthy merchants interested in investing surplus capital in lucrative undertakings. As there were few attractive outlets for these surplus funds, many merchants lent to other businessmen and, if the loan had a fixed term, accepted deposits in

preparation for repayment. In this manner the merchant evolved into a banker. By contrast, before 1790, most merchants in the United States had not accumulated enough surplus capital to engage in such private lending. Because of the shortage of liquid capital in the private sector, most banks in the United States were formed through pooled capital. (5)

In 1781, the Bank of North America was chartered to engage in commercial banking. This event marked the formal introduction of commercial banking to the United States. The business of banking involved a group of investors setting aside a reserve of specie from their own funds to form the banks capital. The bank then solicited deposits and made loans. Early banks invested in government bonds, in short-term notes, and in a few sound urban mortgages. Only on occasion did a bank make an unsecured loan. Loans generally took the form of paper bank notes (i.e., bank obligations to redeem specie on demand, and issues in exchange for the borrowers' promises to pay back the loan with interest). Often, bank notes were exchanged for specie at the issuing bank. Banks, however, preferred the notes to circulate as money. The more notes in circulation, the larger the sum of interest-bearing loans the bank could make. Individual states frequently required chartered banks to subscribe to a large amount of state bonds or to give stock to the state in return for its charter. Beyond that requirement, few states required banks to hold reserves. In the few states which did, reserve requirements applied to notes issued, not to checks or deposits. (6)

Initially commercial banking in the United States spread slowly, but bank development became more rapid as the American economy grew away from

colonialism. In 1790, four banks operated in the United States, with assets totalling \$2.5 million. By 1795, the number of banks rose to 23, and by 1800 there were 28 commercial banks with total assets of \$21 million. From 1800 to 1805, the number of banks increased dramatically--by 300 percent--to 75, their assets reaching \$40.4 million. (7)

The Early National Economy

As the colonial period came to an end, the United States economy slowly embarked upon the building of a nationwide economic structure that would support long-run economic growth and development. However, it became clear that despite its newly won political independence, the American economy remained linked to the economies of Europe. The effect on the American economy of the Napoleonic Wars (1793-1815) between Britain and France bears testimony to this fact.

From 1793 until 1807, the Napoleonic Wars produced tremendous profits for American shipping, shipbuilding and agriculture interests. To maintain trade with their respective colonies, Britain and France agreed to a non-aggression pact on neutral shipping. Thus, neutral American ships supplied the bulk of Europe's shipping needs while American producers supplied the resources and foodstuffs for export to Europe. During these years, American exports increased from \$19 to \$49 million, and re-exports rose from \$14 million to \$60 million. (8)

The boon to American shipping ended in 1808, as both Britain and France began interfering with American shipping. At that time, the United

States lacked the naval strength to protect its ships. To avoid being drawn into the war, President Jefferson declared an embargo which not only kept American ships off the seas but which effectively prohibited all American exports.

The embargo so seriously impeded the American export (and reexport) trade that commercial interests pressured for its repeal. In its place a Non-Importation Act was passed prohibiting trade specifically with Great Britain, France, and their respective colonies. In addition to limiting exports, the trade restrictions also limited the flow of foreign goods to the United States. As a result, much of the capital which was previously invested in commercial trade flowed into import substitution industries.

American's attempt at domestic production was concentrated in cotton textile production, which occurred in New England, precisely where the greatest amount of surplus capital existed. While there had been some production of cotton textiles, it was not until the trade embargo that it began in earnest. As a gauge to the extent of this process, the number of spindles in cotton textile production rose from 20,000 in 1809 to 135,000 by 1815, whereas domestic consumption of cotton rose from 500 bales in 1805 to 90,000 bales by 1815. (9)

Following the cessation of British and French hostilities in 1816, competition from British textile manufacturers forced many American cotton textile firms to cease operations. American economic activity, as a result, shifted back to the export and (re-export) trade. The Napoleonic Wars did, however, provide a lasting, long-term benefit to the economy as a portion

of the profits accumulated prior to the embargo were invested in other economic activities, most notably a transportation network that linked various regional markets together. The construction of this transportation network has proven to be an extremely important factor in the economic development of the United States. (10)

First to be developed was transport by water. Prior to 1815, river transportation was limited to downstream navigation by raft and flatboat. Western agricultural goods were transported down the Mississippi and Ohio rivers for sale in the South and ultimately to European markets. Some upstream navigation by keelboat was also carried on, but such navigation was a difficult and relatively expensive means of transporting goods. As a result, to reach Eastern markets, Western food producers either had to incur the relatively high costs of wagon transportation or endure the slow route by river to New Orleans, followed by ocean shipping to Eastern seaboard markets. Consequently, only high-priced, low-weight goods could be profitably exchanged through interregional trade.

Canals were the first feasible means of direct East-West transportation. During the 1820s and 1830s canals provided a new, inexpensive form of transport which rendered profitable the exchange of Western agricultural products for Eastern (and foreign) manufactured goods. Nevertheless, because of the costs and slow speeds of canal transportation, they were used primarily for the transport of high-weight, low-priced goods such as grain, lumber, ore, and coal.

Water transportation was revolutionized with the introduction of the steamboat. In the East, where alternative forms of transportation existed, such as toll roads and canals, steamboats were used primarily for passenger traffic. However, steamboats were used for transporting freight and agricultural goods in the South and Midwest.

Initial railroad construction, which began as early as 1830, was limited to Eastern seaboard states and largely duplicated canal routes. The first major expansion in railroad construction occurred during the 1850s at which time the speed and seasonal advantages of railroad transportation could largely offset the cost-differential with respect to other types of transportation. During the 1850s, railway mileage increased from approximately 9,000 miles to almost 31,000, with most of the construction taking place in the Midwest. The Civil War interrupted railway construction during the 1860s, but construction once again boomed in the 1870s and 1880s as transcontinental routes were built.

The development of an internal transportation system had far reaching effects on national economic growth and development. By linking together local markets, this transportation network facilitated the creation of national markets. Agricultural production in the expanding West became vitally linked to manufacturing production in the East. With the reduction in shipping costs of staple crops, the agricultural sector moved from low yielding areas to the rich Midwestern regions. The fertility of these lands served to increase agricultural productivity and to reduce the labor requirements of agriculture. Consequently, farm labor was released for employment in the manufacturing sector.

In addition, agricultural development led to increased demand for agricultural machinery and farm implements. As a measure of the structural change in farming, the share of agricultural equipment as a portion of the total output of manufactured producers' durables doubled between 1839 and 1859. Such growth induced investment pressures in the East, which increased employment, absorbed more immigrant labor, and necessitated the further expansion of agricultural production. (11)

In addition to the tremendous strides made in transportation and agriculture, this period of American economic history is also characterized by rapid urbanization. The proportion of the population living in U.S. cities (places of 2,500 individuals or more) was only 6.1 percent in 1820, and there had been little change since the census of 1810. But from this time until the Civil War, cities grew at a rate more rapid than at any time in the history of the United States. By 1860, close to 20 percent of population were city dwellers. Between 1820 and 1860, the total population of the United States rose 226 percent and the proportion living in cities increased 797 percent. The most rapid urbanization took place in the two decades preceding the Civil War. Total population increased 35.9 percent during the 1840s and 35.6 percent in the 1850s. During the same decades, the urban population grew at a rate of 92.1 percent and 75.4 percent, respectively. This is in contrast to 1820, when only 12 cities had a population exceeding 10,000 and only 2 had populations which were greater than 100,000. Forty years later, in 1860, 101 cities had populations which exceeded 10,000, 8 exceeded 100,000, and New York had passed 1,000,000. (12)

By 1860, the urban-industrial city had not fully arrived. Finance, commerce, and trade-related activities still dominated urban economies. This notwithstanding, manufacturing was emerging as an important factor in urban growth. In New York and Boston, 10 and 11 percent, respectively, of their populations were engaged in manufacturing. Two of the great commercial cities, Philadelphia with 17 percent employed in manufactures, and Cincinnati with 18 percent, owed almost as much to industry as to commerce. Finally, predominately manufacturing cities were also appearing during this era. For example: In Newark, 26 percent of the population was employed in manufacturing; in Lowell 36 percent; and in Lynn 45 percent. These were the forerunners of the industrial cities of a later period. (13)

By the eve of the Civil War, an integrated, national economy had superseded the colonial economy of early America. No longer was American economic activity concentrated along a narrow strip extending no farther inland than a hundred miles from the Atlantic coast. The American economy was also no longer dependent on European markets for growth. The changes heretofore discussed, especially those in transportation, had resulted in the creation of a new and dynamic national economy.

Transportation improvements, urbanization, rapid population growth, early industrialization, and the settling of new land produced new demands for capital. As occurred during the colonial period, the process of economic development generated a demand for an institutional form of financial intermediation to meet its demand for financing.

With the demands of urbanization, the need for adequate financing of homes was also prevalent among the expanding population of the early nineteenth century. Mortgage banking was one such institutional form that emerged and fulfilled the need to support long-term economic growth and development on the basis of long-term financing.

In practice, mortgage banking originated when an individual, usually a lawyer or real estate broker, arranged a loan for a farmer, a homeowner, or a businessman in exchange for a nominal fee. The mortgage was then sold to an investor, or a group of investors, who would retain the security until the loan was paid. Gradually this practice developed into two basic institutional forms of mortgage banking, namely the mutual savings bank and the savings and loan association.

The first mortgage bank to appear was the mutual savings bank. As early as 1816 the first such bank opened for business in Massachusetts. The word "mutual" indicates the form of legal ownership of the institution. Its charter authorized its operation for the mutual benefit of the depositors, who were the owners of the bank. As owners, the depositors received a share of the bank's earnings. While this type of institution was organized to be a safe and interest-earning repository for household savings, its primary function was to engage in mortgage lending. (15)

Mutual savings banks formed primarily along the eastern seaboard of the United States, and have remained concentrated in this area ever since. In other parts of the country, savings and loans associations emerged as the counterpart to the mutual savings bank. (16) In 1831, the first

savings and loan association in America was established as the Oxford Provident Building Association which was organized in the small factory town of Frankfort, Pennsylvania. This was the initial step in a movement to help consumers obtain long-term financing for residential construction. The early savings and loan associations performed two basic functions:

1. They encouraged thrift by providing opportunities for the investment of savings, and
2. They made funds available for financing the purchase and improvement of homes.

These early associations were unincorporated and voluntary, with little government intervention. During this early period, the typical association had meager resources and thus, problems of management were insignificant. There was need for neither full time officers, nor formal office buildings in which to carry on transactions. All business was conducted at weekly meetings, held in the homes of its members or in back rooms of store buildings. The primary purpose of these meetings was to receive whatever cash members were ready to deposit and to process loan applications which were on file. Loans made were based on the character and stability of the borrower, with only minor concern for the quality of the security or collateral with which the loan was to be supported. The need for home mortgages grew wherever the factory system flourished, and so the savings and loan movement rapidly spread as industrialization spread throughout the United States. (17)

The Post Civil War Economy

The industrialization, urbanization, and transportation improvements (most notably the construction of transcontinental railroads) during the first six decades of the nineteenth century continued into the late nineteenth century. These trends were accompanied by technological innovation in agriculture, manufacturing, communication, marketing, and in the distribution of commodities. Some important qualitative changes became recognizable as well. Most relevant to credit unions was the emergence of large-scale industrial production and the consequent creation of a class of urban wage-earners. Because urban wage-earners were not in a position to produce consumption goods to meet their own needs, they relied on their wage income to satisfy their demand for consumer goods. (18)

Whereas nascent industry had emerged during the second decade of the nineteenth century, large-scale industrial production did not appear until the post-Civil War era. Before that time, manufacturing was conducted in simple facilities. For example, except for textile production, most domestically manufactured goods were produced in small household shops and for local markets. Production on a larger scale became feasible only when the transportation improvements of the early and mid-nineteenth century allowed the development of a firmly established national market. (19)

Fueled by the development of a national market, rising income, and a rapidly increasing population in the latter half of the nineteenth century, large scale production spread quickly. In his TRIUMPH OF AMERICAN CAPITALISM, Louis Hacker provides data detailing the growth in

manufacturing from 1850 to 1880. During this period, the value of capital invested in manufacturing increased over 423 percent. Value added in manufacturing increased over 325 percent and wages paid out in manufacturing rose over 300 percent. Hacker's data indicates moderate growth in the value of output produced in light industries (e.g., textiles, shoes). However, he points to the boom in heavy industries, where the value of pig iron produced rose by 600 percent from 1850 to 1880. The value of agricultural implements and machinery produced rose by 900 percent and 665 percent respectively over the same thirty-year period. (20)

Other data indicates not only an acceleration of the growth in manufacturing output but also a trend toward large-scale industrial production in that sector. During the last twenty years of the nineteenth century, real value added in manufacturing plants more than doubled, rising from \$9,787 in 1880 to \$17,012 in 1900. This growth accelerated in the early twentieth century, as real value added per manufacturing plant quadrupled between 1900 and 1920, rising to an estimated \$64,975 by 1920. Whereas manufacturing employment grew slowly during the nineteenth century, it more than quadrupled from 1900 to 1920, rising from an estimated average of 11.1 to 49.9 workers per plant. (21)

Growth of industrial production was accompanied by a decline in the proportion of the labor force employed in agriculture. In 1840, 68.6 percent of the labor force was employed in agriculture, forestry and fishing. By 1860, this sector employed 59.5 percent of the labor force; by 1880 and 1900, 50.1 and 37.6 percent of the labor force were employed in

these sectors, respectively. By 1920, agriculture accounted for 27.4 percent of total employment. (22)

The urbanization which began earlier in the nineteenth century also continued. Between 1865 and 1900, over 12 million European immigrants arrived in search of employment. Most of them settled in urban areas and were joined by streams of people leaving the nation's farms. As a result, urban areas grew more numerous and larger in size. According to Census Reports, the total urban population grew more than threefold between 1850 and 1880; from 1880 to 1900, urban population almost doubled; from 1900 to 1920, the urban population grew by 150 percent. (Note, these figures refer to urban areas containing 2,500 inhabitants or more.) What is more noteworthy is the growth of large urban areas. In 1860, 9 urban areas boasted a population of 100,000 persons or more; by 1880, there were 20 such places; by 1900, 38; and by 1920 there were 68 urban areas with populations exceeding 100,000 people. Between 1860 and 1880, the number of urban areas having populations of between 50,000 to 100,000 inhabitants rose from 7 to 15; by 1900 there were 40 such areas, and by 1920, they numbered 76. (23)

Large-scale industrial production also initiated the development of a corresponding means of marketing and distributing of industrial output. Retail outlets, such as department stores and mail-order catalogs, provided relatively efficient forms of marketing and distributing a wide array of goods to consumers. Department stores offered a wide variety of commodities at relatively low prices, and such services as free delivery and charge accounts. Chain store organizations offering specialized lines

of products, such as groceries, hardwares, and drugs became popular in the medium and smaller sized cities. In rural areas, consumers had access to a wide variety of goods through mail-order houses such as Sears-Roebuck and Montgomery Wards. By 1900, the linking of mass production with a nationwide distribution network established the basis for a economy in which consumer demand could be met through market exchange. (24)

Out of this long economic growth process, stretching from 1800 to the end of the end of the nineteenth century, there arose a class of urban wage earners. These urban dwellers used the income from the sale of their labor to purchase consumer goods. The appearance of a mass of wage-earners (consumers) and the emergence of large scale consumer goods production initiated a demand for a new form of credit, namely consumer credit, to finance consumption on a mass scale.

A diverse array of lending agencies appeared to meet the demand for consumer credit. These included installment loan agencies and pawnbrokers. Some department stores provided credit accounts for their customers, and some employers made loans to their employees under certain conditions. Employers also accepted deposits from their employees, thus acting as a repository for employee savings. Usury laws during the late nineteenth and early twentieth century, however, established an interest ceiling on consumer loans which did not compensate lenders for the perceived risk and costliness of extending such loans. These usury ceilings generally held back the development of formal consumer lending agencies and consequently these types of financial institutions spread very slowly. In the interim, however, illegal forms of consumer lending arose. These

included the fraudulent practice whereby illegal lenders (later called "loan sharks" and "money shavers") charged usurious effective rates of interest without technically violating usury laws.

Efforts to eradicate the practice of illegal lending or "money bootlegging" began in the late nineteenth century with the establishment of the first remedial loan societies. Some of these loan societies were entirely charitable in character, while others operated on a limited-profit basis. The first to emerge was the Provident Loan Society of New York (1884). Attempts to solve the consumer credit problem, however, did not take a widespread, organized form until the twentieth century. It is to the situation of the early twentieth century and the credit union movement that this dissertation now turns. (25)

Footnotes

(1) For more on structural economic change and American economic growth, see Alfred H. Conrad's "Income Growth and Structural Change," in American Economic History, Seymour E. Harris, ed., (McGraw-Hill, 1961), pp. 26-64. See also Arthur Schlesinger Jr., "Ideas and The Economic Process," in the same volume, pp. 3-25.

(2) An analysis of British economic policy and the American colonies is contained in U.S. Economic History, Albert W. Niemi, Jr., (Rand McNally College Publishing Company, 1975), pp. 23-38. See also, Douglas F. Dowd The Twisted Dream: Capitalist Development in the United States Since 1776, (Winthrop Publishers, 1974), pp. 5-8 for an analysis of British policy.

(3) Niemi, Ibid., discusses the pattern of American colonial production. pp. 26-30.

(4) J. Walter Elliot, Money, Banking, and Financial Markets, (West Publishing Co., 1984), pp. 106-07.

(5) Thomas Cochran provides an insightful analysis of the relationship between early American merchants and the development of commercial banking in the United States. See 200 Years Of American Business, (Dell Publishing, 1977), pp. 31-41.

(6) Ibid.

(7) For a short description of early American commercial bank growth, see J. G. Gurley and E. S. Shaw "Money," Seymour E. Harris, ed., American Economic History, pp. 107-109. See also U.S. Department of Commerce, Bureau of the Census, Historical Statistics of the United States, 1789-1945, 1949, Series N-13.

(8) John O'Sullivan and Edward F. Keuchal American Economic History: From Abundance To Constraint, (Watts Publishing, 1981), pp. 33-92. See also Albert W. Niemi, Jr., U.S. Economic History, (Rand McNally College Publishing Co., 1975) pp. 39-110.

(9) Victor S. Clark, History of Manufactures in the United States, Vol. 1, (McGraw-Hill for the Carnegie Institute of Washington, 1929), p. 247. Cited by Albert W. Niemi, Jr., U.S. Economic History: A Survey of the Issues, (Rand McNally College Publishing Co, 1975), p. 47

(10) See Merton J. Peck "Transportation in the American Economy," American Economic History, Seymour E. Harris, ed., (McGraw Hill, 1961), pp. 340-365. See also Albert W. Niemi, U.S. Economic History, pp. 51-92.

(11) John O'Sullivan and Edward F. Keuchal American Economic History: From Abundance To Constraint, (Watts Publishing, 1981), pp. 33-94. Also "Agriculture," John D. Black, in American Economic History, Seymour E. Harris, ed., (McGraw Hill, 1961) pp. 483-521.

- (12) George R. Taylor "The National Economy in 1860," in Barry E. Supple, ed., The Experience of Economic Growth: Case Studies in Economic History, (Random House, 1963), p. 257.
- (13) Ibid., p. 256.
- (14) On the origins of mortgage banking, see Cochran, 200 Years of American Business, pp. 92-97.
- (15) Mortgage Banking, Robert H. Pease and Lewis O. Kerwood, (McGraw Hill, 1965), pp. 93-110.
- (16) Ibid., pp. 83-92.
- (17) Alan Teck, Mutual Savings Banks and Savings and Loan Associations: Aspects of Growth, (Columbia University Press, 1968), p. 24. See also Mortgage Banking, Robert H. Pease and Lewis O. Kerwood, (McGraw Hill, 1965).
- (18) Louis M. Hacker, The Triumph of American Capitalism, (Columbia University Press, 1940), pp. 267-279. For an analysis of the earlier emergence of the English working class see, The Making of the English Working Class, E. P. Thompson, (Vintage Books, 1966); Also, The Industrial Revolution In The Eighteenth Century: An Outline Of The Beginnings Of The Modern Factory System In England, Paul Mantoux, (Harcourt, Brace and Company, 1927).
- (19) The creation of a national market is described in Thomas Cochran, 200 Years Of American Business, (Dell Publishing, 1977), pp. 51-109.
- (20) Louis M. Hacker, The Triumph of American Capitalism (Columbia University Press, 1946), Appendix A, pp. 437-38.
- (21) Albert W. Niemi, U.S. Economic History, (Rand McNally College Publishing Co, 1975), Table 7-2, p. 97.
- (22) Ibid., Table 7-1, p. 95.
- (23) George R. Taylor "The National Economy in 1860," in Barry E. Supple, ed., The Experience of Economic Growth: Case Studies in Economic History, (Random House, 1963). See also Department of Commerce, Bureau of the Census, Historical Statistics, Series D 145-149.
- (24) See Thomas Cochran, 200 Years Of American Business, (Dell Publishing, 1977), pp. 113-131.
- (25) For an analysis of the illegal loan business see Consumer Credit and Its Uses, Charles O. Hardy, ed., (Prentice Hall, 1938), pp. 73-82; Financing the Consumer, Evans Clark, (Harper and Brothers, 1930), pp. 32-39.

CHAPTER THREE

The Emergence and Early Development of Credit Unions

This chapter considers the conditions surrounding the emergence, growth, and development of credit unions during the early part of the twentieth century. It continues to conceptualize the development of financial institutions as a byproduct of the process of economic development. Like the previous chapter, this chapter traces the development of new demands for credit, specifically consumer credit, and the various financial institutions which emerged as a result. The focus, therefore, turns to the economic development process as it unfolded during the early twentieth century, when consumer credit and specialized consumer lending agencies first appeared and grew widespread.

This chapter begins with an examination of economic developments in the United States from 1900 through the mid-1930s. The broad structural trends delineated in this opening section include: A brief description of generally prosperous economic conditions of the time, which were fed by lucrative outlets for capital in the form of new industries and technologies (in the domestic economy); the continued relative decline in importance of the agricultural sector; the spread of big business through mergers; the beginning of active government involvement in the working of the economy.

Having established a broad economic context, the discussion turns to the development of consumer credit, from its nascent forms in the nineteenth century to the establishment of institutions specializing in consumer lending. It will be shown that as households gradually produced

fewer of their own consumption goods and supplied only their labor in return for a wage, the need for consumer credit sharpened. At the same time, the widespread development of industrial production intensified the dependence of industry on adequate aggregate demand. Since consumption is a vital component of aggregate demand, mass production required mass consumption as a condition of its viability.

The chapter then turns to the early development of credit unions within the context of long-term economic development and the evolution of consumer credit. Prior to 1921, credit unions were sporadically organized and limited data is available with respect to early development. Thus, the discussion briefly addresses the credit union movement from its inception in 1909 until 1920, when organized efforts began to promote credit unions. Indeed, not until 1934, when the Federal Credit Union Act became law, did credit unions proliferate and was data systematically and consistently gathered. The statistical treatment of credit unions in this chapter reflects the paucity of data and the state of the movement (which will be described verbally and, to the extent possible, statistically) until 1934. This chapter also focuses on the pioneers of the early credit union movement and defines their philosophical orientations/approaches to credit unions. These early pioneers determined the philosophy and operational form to which credit unions would adhere until the mid-1970s.

The Economy

During the first three decades of the twentieth century, new industries, embodying new technologies, appeared and grew rapidly. As domestic market expansion encouraged large increases in domestic output, large scale industrial production became firmly entrenched in the U.S. economy. This development was accompanied by additional population growth, urbanization, rapid technological innovation, and a continued decline in the relative importance of agricultural production. Large scale production stimulated the further growth of an urban working class. Large scale production also led to a reformulation of the federal government's role in the national economy.

The years from 1900 to 1929 were marked by relatively buoyant economic activity. Alvin Hansen notes this period witnessed only two major recessions, the first lasting from 1907 to 1908 and the second from 1920 to 1921. (1) Rapidly expanding domestic markets provided profitable avenues for capital investment in many spheres of production. In general, street railways, electrical power generation, telephone, and automobiles were the most rapidly growing areas of production. These new industries also contributed to the growth process in so far as they consumed other industrial products as inputs. The production of the automobile, for example, fed the growth of industries producing goods, such as glass, petroleum, rubber, steel and public roads. (2)

The period was also marked by two waves of intense business consolidation. Through outright purchase of another firm or acquisition of

a majority of another firm's stock, many corporations widened the scope of their operations quickly. The first wave of mergers was concentrated in the years between 1898 and 1902. The prosperity of the 1920s and congenial business/government relations provided favorable conditions for another wave of mergers during the 1920s. By 1929, the largest one-hundred U.S. corporations owned over thirty-eight percent of all assets in manufacturing. (3)

The early decades of the twentieth century also witnessed a transformation in the importance and role of government in the economy. On the state and local level, the social needs resulting from the development of an urban-industrial society compelled governmental units to continually expand their role in the functioning of the economy. The most dramatic adjustments, however, occurred at the federal level with the federal government assuming the role of regulator of big business. Corporate mergers during this period led to the passage of legislation designed both to enhance competition and to curb abuses arising out of growing corporate market power. By 1914, the federal government moved from laws banning specific practices (as embodied, for example, in the Sherman Anti-Trust Act of 1890 and the Interstate Commerce Act of 1887) toward the establishment of permanent regulatory commissions, as embodied in the Federal Trade Commission Act of 1914.

The federal government's influence on currency and credit conditions was extended through the establishment of the Federal Reserve System in 1913. A fundamental defect of the nineteenth century U.S. banking structure was its inability to adjust credit and currency conditions to reflect

and/or offset short to intermediate term fluctuations in economic activity. Prior to the establishment of the Federal Reserve System, credit and currency conditions were generally determined by state banks, which operated under a widely divergent set of state banking laws. Thus, during much of the nineteenth century, the U.S. economy functioned without a central bank to standardize its currency. The absence of a central bank also precluded a means of systematically influencing the availability of money and credit. The creation of the Federal Reserve System addressed this deficiency and generally enhanced the role of the banking system in facilitating the economic growth process. (4)

The role of the federal government in the economy also expanded as a consequence of wartime production. The enormous task of production for World War I required that aggregate production be coordinated so as to effectively allocate the nation's resources. Upon cessation of hostilities, wartime economic control was abandoned. Nevertheless, by the start of the second World War the federal government had acquired (permanently, as it turned out) the task of maintaining economic stability. A responsibility which the government first accepted as a result of the Great Depression.

One indication of growing governmental involvement is rising public sector employment, both in absolute terms and as a percent of total non-agricultural employment, between 1900 and 1929. For example, the number of employees on governmental payrolls increased from 1 million to 3 million between 1900 and 1929. In 1900, the government employed 7.2

percent of all nonagricultural employees; by 1929, this had increased to 10.4 percent. (5)

Both in terms of its share of national income and in terms of total employment, agriculture continued to decline in relative importance. For example, on average, an estimated 18.2 percent of national income accrued to the agricultural sector from 1899 to 1903, while the agricultural share of national income dropped to 9 percent by the late 1920s. (6)

In marked contrast to the relative decline of agricultural production was the increasing importance of the manufacturing and public sectors to national income. At the turn of the century, manufacturing accounted for 18.6 percent and the public sector for 6 percent of national income. However, by the late 1920s, manufacturing accounted for 22 percent of national income, while public sector employment accounted for 8.7 percent of national income. (7)

With regard to the sectoral distribution of employment, in 1900, a labor force of 29 million workers included 11.7 million employed in agriculture and 5.9 million employed in manufacturing. By 1920, agricultural employment fell to 10.8 million or twenty-five percent of a labor force of 41.6 million workers, whereas employment in manufacturing rose to 11.2 million workers. (8)

Between 1900 and 1930, the population of the United States rose by more than sixty percent, from 76 million to 122.8 million inhabitants. (9) Urban populations grew even more rapidly as urban growth was fueled by both

an influx of emigrants from American farms and the nineteen million immigrants arriving during this period. The bulk of the latter (approximately twelve million) arrived in the United States before 1915.

(10) Most of the immigrants were semi-skilled and/or unskilled workers who sought employment in the cities. As a result, the urban population increased from 6.2 million in 1900 to 68.9 million by 1930. (11)

The generally depressed economic conditions lasting from 1929 to the late 1930s/early 1940s interrupted the aforementioned trends. Whereas real GNP rose from \$76.9 billion in 1900 to \$203.6 billion in 1929, by 1932 it had dropped to a depression low of \$141.2 billion and did not regain its 1929 level until 1940. Real per capita GNP did not surpass its 1929 level of \$1,761 until 1940. The unemployment rate rose from 3.2 percent of the total labor force in 1929 to 24.9 percent in 1933; nonagricultural employment plummeted during the depression and did not surpass its 1929 level until 1940; agricultural employment continued to decline even after the Depression. Government payrolls alone increased. Immigration to the United States from 1930 to 1939 totalled less than 700 thousand persons. During this period, the rate of growth of the urban population fell to 13 percent while the general population increased only seven percent.

From the perspective of political economy, continuing technological innovation coupled with the shifts from the agricultural sectors to industrial production, urbanization, and population growth all involved changes in the social organization of production and induced corresponding social changes outside the immediate sphere of production.

First, a class of urban wage earners had emerged. These individuals were divorced from the traditional mores and systems of mutual assistance that typified the rural American countryside or, in the case of immigrants, of the country of their birth. At one time, these people produced their own consumption goods and relied on the community for assistance in times of emergency. In their new situation, they came to depend entirely upon their money income to meet their consumption needs. The weekly income of urban workers sufficed for the purchase of such necessities as food, coal, etc., but would not permit larger outlays for the purchase, for example, of large quantities of nondurable consumer goods, durable consumer goods, and relatively costly consumer services, such as health care. Families often needed credit to finance expenditures arising out of illness, accidents, unemployment, and marriage. (13)

Second, large-scale industrial production was accompanied by a new form of business organization. The modern corporation, with its access to larger pools of capital and the protection of limited liability, replaced partnerships and proprietorships as the dominant form of business organization. In 1904, over 70 percent of value added in manufacturing originated from corporate-owned establishments. By 1929, corporations accounted for over ninety percent of all value added in manufacturing. This new corporate structure, producing for both national and international markets, employed and coordinated the labor of large groups of people under the roof of one factory. Large-scale production thereby created a common bond amongst the workers and a basis for cooperative relations outside the immediate sphere of production. (14)

Third, the federal government became a major participant in the macroeconomy. On the one hand, the federal government was in a certain sense the regulator of business, whereas on the other hand, the federal government was rapidly becoming the largest single employer of the newly emergent working class. (15)

As a product of nineteenth century industrialization, mass consumption and the accompanying demand for consumer credit were relatively new. The latter emerged in a legal, institutional, and ideological environment unprepared to meet it. First, banks extended mainly commercial and investment credit, while saving and loan associations extended primarily mortgage credit. Second, usury laws established interest rate ceilings which reflected the costs and risks associated with commercial loans. These interest rate ceilings did not compensate for the greater costs and higher risks associated with supplying small, unsecured consumer loans. Third, commercial loans were repaid in lump sums, whereas the weekly and monthly income flow of urban wage earners made small, periodic payments more practical. Finally, a lingering nineteenth century ideology encouraged thrift, productivity, and eschewed borrowing to finance consumption. Indeed, the early credit unions were formed primarily to encourage thrift and address the credit needs arising out of emergencies. The credit union emphasis on remedial loans waned only after the second World War, when wages and job stability improved considerably for credit union members.

Pre-Civil War Consumer Credit

Early nineteenth century households produced not only goods for export to Europe but they also produced the majority of their own consumption goods. Articles that could not be produced in the home were purchased through market exchange. The first forms of consumer credit developed as a direct product of trade in consumer goods. Credit extended to households by merchants (in urban areas), peddlers, and storekeepers (in rural areas) financed purchases of both consumer goods and productive inputs. (16)

Term credit gained popularity during the early nineteenth century. It involved the sale of a commodity in exchange for a partial cash payment and a note payable in sixty to ninety days. Such credit generally required credit applicants to prove their reliability, and to repay the loan at a specified date. In rural areas, horses, plows, carriages, seed, clocks, and household furniture were frequently sold for promissory notes payable after the harvest. In urban areas, craftsmen and merchants sold furniture, stoves, and other relatively expensive goods under similar terms. Term credit was popular from the early to the mid-nineteenth century. While its use declined progressively in urban areas during succeeding decades, in rural areas term credit persisted well into the 1860s. (17)

While more expensive goods were commonly sold through term credit, relatively inexpensive goods were sold either for cash or through open-book credit. Merchants extended such credit by debiting customer accounts as purchases were made. Although open book credit involved no formal promise of repayment of a fixed sum at a specified date, purchasers were expected

to restrict their outstanding balances according to their ability to pay and to settle their debts as income was received. (18)

In the early nineteenth century open-book credit appears to have been granted most liberally throughout agricultural areas. Since few banks were located in rural areas, general store merchants and rural peddlers often financed their customers' purchases of consumer goods and agricultural inputs, usually through credit extended to them by their suppliers. Customer accounts were generally settled only after cash crops had been marketed.

In urban areas, open book credit was extended to professional people, wage earners, and businesses. By 1850, open-book credit became a common practice in many urban areas, as bakeries, clothing stores, drug stores, dry-goods stores, grocery stores and shoe stores began extending this form of credit to their customers. In some factory towns during the 1820s and 1830s, a few firms paid employees with store orders charged to their account with a local merchant. These charges were then settled annually. Like much of the credit extended to farmers by general store merchants, this particular form of open-book credit represented intermediate-term financing of production.

During the first half of the nineteenth century, a limited form of installment credit appeared in connection with trade in expensive durable goods, such as stoves, sofas, beds, and pianos, which retained a relatively high resale value. Downpayments were substantial and repayment periods generally short. Such credit was usually extended only to individuals with

proven credit records and whose income allowed them to easily meet scheduled payments. (19)

Installment credit differed from open-book credit along the following lines:

- Installment credit was granted in connection with the purchase of a single, specific item.
- Installment credit involved a formal contract whereby the merchant retained title to an article until its sale price had been fully paid.
- The purchaser agreed to make regular periodic payments.
- The installment arrangement required partial cash payment at the time of purchase.

Since the aforementioned forms of consumer credit were the direct result of the retail trade in consumer goods, usury laws were circumvented by including compensation for the credit service in the price of the goods. As will be discussed below, this is in contrast to cash-lending agencies which functioned as formal loan institutions. These institutions charged prices which reflected the costs of the credit advanced. As such, these loan agencies directly confronted usury laws, and their history is inseparably related to the avoidance of those restrictive statutes.

The pawnbroker was the first to engage in general cash lending. By 1800, pawnbrokers were very well-established in major eastern seaports. They advanced money or goods against tangible property delivered into their possession. As such, the pawnbroker was a unique blend of merchant and cash lender. At times, the pawnbroker was as an important source of short-term

business credit. However, as banks proliferated, the pawnbroker gradually focused solely on consumer lending. (20)

Banks played a minor role in granting consumer credit during this period. Rather than invest funds in consumer loans, banks lent their funds to commercial, industrial, and agricultural concerns. In special cases, banks would extend credit on a small scale to long-time depositors and applicants who could procure an acceptable cosigner. However, because these loans were made at commercial rates of interest they were unprofitable. Consequently, they were made sparingly and only as a gesture of goodwill on the part of bank to preferred customers.

In brief, prior to the Civil War there was comparatively little need for financial institutions specializing in consumer credit. Consumer credit was extended on a limited basis by merchants engaged in retail consumer trade. Other major household expenditures and financial emergencies were met by social conventions or by family groups, church parishes, or the community as a whole.

Post-Civil War Consumer Credit

As discussed in the previous chapter, the Civil War marked the beginning of a breakdown in the social cohesion which made mutual, community assistance possible. Growing urban/industrial areas attracted masses of wage earners to man the machines of production. These people left the intimate communities where they enjoyed the security of partial self-sufficiency and the protection of family and community. They moved to

impersonal cities, where their means of subsistence depended on the continuous flow of pay-checks. They arrived with a substantial demand for household consumption goods and with little or no financial resources to draw upon. Since wage incomes generally left little margin for emergency expenditures and the purchase of durable consumer goods, the traditional incentives for thrift waned. In the city, family tradition, conservative consumptive habits, and reputations for stability gave way to new consumption needs and dramatically altered life styles and living standards. (21)

Industrialization and its social implications in part explain the extension and emergence shortly after the Civil War of two specialized forms of consumer credit, namely the extension of installment credit and the appearance of lenders specializing in small personal loans.

The conservative policies that characterized installment credit prior to the Civil War eroded in many areas shortly after the War. The liberalization of terms occurred first among furniture dealers in the new industrial centers of the Middle West. Wage-earners in urban areas were in need of household goods and could buy them only on credit. In order to expand sales in this market, some easing of credit terms as well as the extension of credit to people formerly considered poor credit risks became necessary. For example, by 1870, furniture dealers in major industrial cities began selling goods for a small down-payment and a long-term contract to wage-earners of very modest incomes. By the 1870s, installment credit appeared in the sale of goods such as bedding, clocks, jewelry, kitchenware, and clothing. (22)

During the 1870s-1880s, installment selling expanded progressively along three fronts:

- Installment credit spread geographically,
- The variety of goods sold on installment terms increased,
- Credit was extended to lower income groups and relatively poor credit risks.

The expansion of installment selling first appeared and spread most rapidly throughout larger industrial cities. The expansion, occurred around the sale of low-priced goods to low income groups.

The extension of installment selling to low-income groups was paralleled by the rise in the number of businesses specializing in personal cash loans at relatively high rates of interest. With usury laws enforcing effective interest rate ceilings, it was generally unprofitable to legally supply the small cash loan market. As a result, illegal cash lenders arose. These lenders were commonly known as loan sharks. The practice of loan sharking first appeared in Chicago during the 1870s and subsequently appeared in nearly every major metropolitan center in the United States. Loan sharks either openly ignored usury laws or employed some form of deception to evade the spirit of the law. The exorbitant rates of interest charged earned them enormous profits. (23)

Two forms of credit became prevalent among loan racketeers. One was based on chattel mortgages on household furniture and the other on wage attachments. The rates charged by chattel mortgage lenders ranged from six to fifteen per cent per month, and the size of the loan varied from ten to

two hundred dollars. The salary-buyers extended smaller average loans of between five to fifty dollars and charged higher interest rates which ranged from ten to forty percent per month. Repayments were often enforced by intimidation. The victims of these loan racketeers were typically workers earning low, but regular wages, and the unemployed. The burden of repaying their debts often forced borrowers deeper into debt and, consequently, into either theft, self-imposed exile, or to suicide.

The social problems surrounding loan-sharking sparked attempts to address the small cash loan situation. As early as the late 1880s, remedial loan societies were established as a weapon in the fight against loan-sharking. Table 3.1 provides a partial list of these societies, their location, and the year they began operations. These philanthropic institutions supplied loans for expenditures arising out of illness, unemployment, and other types of emergencies. However, the need for consumer cash credit by wage earners was too large and too diversified to be met solely through charity. Indeed, city dwellers required consumer credit in a volume so large that remedial loan societies were often plagued with insufficient capital as charitable contributions simply could not provide enough capital to meet the demand for remedial loans. Moreover, interest rate restrictions imposed by usury statutes kept interest rates relatively low and thus restricted the accumulation of sufficient working capital. These factors led to an awareness that consumer credit could be supplied only by entirely new types of consumer finance agencies. (24)

Table 3.1
Remedial Loan Societies

Organization	Location	Began Business
Provident Loan Society	New York, New York	1894
San Francisco Remedial Assc.	San Francisco, Calif.	1912
Collateral Loan Co.	Boston, Massachusetts	1859
First State Pawnors Society	Chicago, Illinois	1899
Provident Loan & Savings	Detroit, Michigan	1906
Equitable Loan Association	Minneapolis, Minnesota	1910
Chattel Loan Society	New York, New York	1912
Welfare Loan Agency	Kansas City, Missouri	1910
Provident Loan Association	Sioux City, Iowa	1912
Workingmen's Loan Association	Boston, Massachusetts	1888
Utica Provident Loan Assoc.	Utica, New York	1912
Citizen's Mortgage Loan Co.	Cincinnati, Ohio	1900
Provident Collateral Loan Co.	Dayton, Ohio	1915
Duluth Remedial Loan Assoc.	Duluth, Minnesota	1918
Worcester Collateral Assoc.	Worcester, Mass.	1896

Source: Evans Clark, Financing the Consumer, (Harper & Brothers Publishers, 1930), Table 12, pp. 104-105.

Of these remedial societies, one played an important role in the credit union movement and in the area of consumer credit in general. In 1907, the widow of deceased railroad baron Russell Sage founded the Russell Sage Foundation with part of her husband's estate. The foundation adopted the premise that the masses were entitled to credit on a business-like basis. The foundation was instrumental in extending emergency loans to the needy. The Foundation supported the prosecution of illegal cash lenders, and also pioneered the development of small loan legislation. (25)

In 1907-1908, the Russell Sage Foundation undertook a series of studies of the loan racketeering business and vividly disclosed its anti-social character. These studies showed that the widespread demand for small loans created a real need for legitimate lending agencies. Moreover,

the studies detailed the nature and consequences of illegal lending and the importance of subjecting existing small loan businesses to public supervision. The publication of these studies was accompanied by legislative efforts to bring small loan companies under state regulation.

On the basis of recommendations made by the Russell Sage Foundation, small loan legislation was enacted in Massachusetts in 1911. In 1916, the Foundation and a group of legal cash lenders drafted a model regulatory act which became known as the Uniform Small Loan Act. The Act adopted the principle of state regulation and supervision in the area of granting credit in small sums on a commercial basis. It sought to induce investment capital to meet the consumer financing need by permitting a maximum rate of interest large enough to absorb and offset the risks and expenses of consumer lending. Subsequently, this Act became the basis of regulating the cash loan business in many states. By 1925, twenty-one states had passed small loan legislation. (26)

Close to the time that the Russell Sage Foundation was established, other consumer credit institutions were also emerging. These included installment finance companies, industrial ("Morris") banks, and credit unions.

Installment finance companies emerged as a subsequent development of aforementioned practice of installment merchandising. The widespread application of installment techniques to the sale of consumer durable goods demanded the investment of substantial capital in consumer credit purchases. Many retailers had neither enough capital nor bank credit

sufficient to finance consumer credit. Consequently, manufacturers began financing dealer inventories to allow the latter to extend credit to consumers. In this manner, manufacturers indirectly financed the retail sale of their products. This practice began in the 1870s and evolved into installment finance companies controlled by the manufacturers themselves. Later, installment finance companies began purchasing consumer receivables from any merchant, regardless which firm manufactured the goods sold.

While this type of credit agency first appeared in connection with the sale of pianos and other relatively expensive durable consumer goods, it attained greater importance with the mass production and mass marketing of automobiles. In general, most consumers could not save the entire price of an automobile and most automobile dealers lacked the capital necessary to finance installment sales. Hence, by 1917, there were at least twenty-five enterprises financing installment sales of automobiles and several of these had begun buying installment contracts from many different type of auto dealers, spread over wide geographic areas. Following World War I, the number of installment finance companies increased rapidly, as installment lending spread to the purchase of a variety of consumer goods.

(27)

In 1910, Arthur J. Morris opened the first Morris Plan industrial bank in Virginia under the name of Fidelity Savings and Trust Company. The bank operated as a hybrid mixture of savings bank and small loan company. Working capital was accumulated from the sale of shares to the general public. The bank did not require loans to be secured by the borrower's assets nor were pledges, mortgage chattel and wage attachments required.

Loans required only the borrower's signature and that of a cosigner. Morris attempted to preserve the form of the traditional transaction between borrower and banker, but he modified it by introducing the practice of the installment payment of the loan. Repayment involved scheduled installments over a definite time period. This method of financing circumvented many state usury laws through a number of devices such as service charges, fines on delinquent loans, and discounting of the loans in advance. After the success of his first bank, Morris opened banks in other cities. Other industrial banks adopted Morris' method of financing small loans and eventually outnumbered Morris' own banks. (28)

The Origins and Emergence of American Credit Unions

Cooperative credit institutions originated in mid-nineteenth century Germany. There were two basic forms which these institutions took: One, led by Hermann Schulze-Delitzsch, addressed the needs of urban craftsmen and shopkeepers, while the other, led by Friedrich Raiffeisen, catered to the needs of small farmers. (29)

In 1850, Schulze organized a cooperative institution in the town of Delitzsch, where he served as mayor. This institution functioned as a philanthropic organization. However, charitable donations proved to be an unreliable source of capital. Two years later Schulze-Delitzsch organized a self sufficient cooperative. Capital was accumulated through the requirement that members purchase shares on which the cooperative paid dividends. Members also assumed unlimited liability for any capital borrowed by the cooperative. The bank was operated on a democratic basis,

with each shareholder exercising one vote regardless of the number of shares held. Members elected employees and officers, who were compensated for their services.

Schulze-Delitzsch institutions did not meet the needs of the small farmer or peasant. Relatively high entrance fees and the high purchase price of shares essentially excluded the small rural farmer from membership. Also, Schulze-Delitzsch institutions extended only short-term loans, whereas farmers generally needed longer term credit to finance the purchase of seed and livestock, improvements to the land, construction of barns, etc.

At the same time urban cooperatives were being formed, Raiffeisen began organizing rural credit cooperatives to supply credit to small farmers. Like Schulze-Delitzsch, Raiffeisen organized his first credit cooperative as a philanthropic institution. However, the need for a reliable source of working capital forced him to also turn to the cooperative principle of self-help. Raiffeisen organized his credit cooperatives around closely-knit groups of farmers who pooled their credit to provide members with loanable funds. As members paid only for nominal-priced shares and relatively low entrance fees, working capital was acquired through borrowing from outside sources, namely German money markets. Members assumed limited liability for funds borrowed through the society. The accumulated funds served as an additional source of working capital for the society.

As in the case of the Schulze-Delitzsch associations, Raiffeisen societies were governed democratically. All members participated in the general meeting with each individual exercising one vote. The members elected a management committee which approved loans and made sure that loans were used for the purpose specified in the loan application. A supervisory council oversaw the responsible behavior of managers and made reports to the general meeting. As Raiffeisen stressed volunteer work in all his unions, full-time cashiers alone received compensation for their services.

While both types of credit cooperatives were based on mutual self-help and democratic control, there were fundamental differences between Schulze-Delitzsch and Raiffeisen societies. Raiffeisen emphasized Christian principles as a basis of operations, whereas Schulze adopted a strict business-like approach that stressed economic viability. Schulze believed that membership should be drawn from a large and economically diverse area, while Raiffeisen restricted membership to small rural districts, generally associated with a church parish.

Credit cooperatives modeled after the German societies were organized in Italy as early as the late 1860s. Credit cooperatives then spread to Belgium, France, Finland, Russia, Switzerland, India, and Canada. The credit union movement spread to the United States through the person of Alphonse Desjardins, who pioneered similar institutions in Canada.

Unlike European credit cooperatives, credit unions in North America secured all, or nearly all, of their capital in cash from the pooled

savings of its membership. In Europe, members generally pooled their credit not their cash. By pooling the combined credit of individual members, European cooperatives in turn borrowed large sums on favorable terms in money markets, and thus, these societies could secure sums on terms more favorable than they could obtain individually. Credit unions in the North America only borrowed additional capital occasionally and were operated with the express purpose of promoting thrift rather than obtaining collective credit. (30)

The first North American credit union was established by Alphonse Desjardin in Levis of the Province of Quebec in Canada. As a journalist, he became disconcerted with the usurious money lending practice being practiced on the workers in Levis and Montreal. Through years of intense study, he acquainted himself with the European credit cooperatives. In 1900, he organized La Caisse Populaire, The People's Bank.

In 1909, Desjardins was asked to assist in the organization a credit union among members of a French Canadian parish in Manchester, New Hampshire. At that same time, Pierre Jay, then bank commissioner of Massachusetts, became interested in cooperative credit societies. Assisted by Desjardins, and with the political influence of Edward Filene, a wealthy Boston merchant, Jay drafted the Massachusetts Credit Union Bill in 1909, which became the first general credit union law in the United States. In 1913, a similar credit union bill was drafted by representatives of the Russell Sage Foundation and enacted into New York state law.

During the early years, credit union development in the U.S. was stymied by the lack of a sustained, organized effort. Attempts at publicizing, organizing, and representing credit unions on the legislative front were scattered and weak. Consequently, from 1909 until 1920, the organization of new credit unions was slow and for the most part confined to urban working people of Massachusetts and New York.

From 1921 to 1934, Edward Filene contributed his political influence and financial resources to the systematic promotion and organization of credit unions. In July of 1921, Filene organized the Credit Union National Extension Bureau (CUNEB) in Boston for the sole purpose of organizing credit unions on a mass scale. Filene hired Roy Bergengren, an lawyer to head the organization. The two men worked under an agreement whereby Filene provided the financing and policy direction, while Bergengren engaged in all the necessary field work. (31)

CUNEB derived its financing almost entirely from the Twentieth Century Fund, a foundation formed in 1919 by Filene to study various means of improving employer-employee relations. Essentially CUNEB adopted a four-fold task:

- To lobby for the passage of state legislation chartering credit unions.
- To encourage and oversee the organization of individual credit unions.
- To overcome popular skepticism concerning the viability of cooperative credit societies.
- To eventually form a national organization of credit unions to supersede CUNEB.

By 1934, CUNEB had realized all the goals that it had set for itself 1921. Credit union laws were established in 41 of the 48 states, which together accounted for over eighty percent of the population of the United States. A major legislative hurdle had been overcome with the passage in 1934 of a federal law allowing credit unions to be chartered anywhere in the United States and its territories. By 1934, a large number of credit unions were operating and 35 state credit unions leagues were functioning to assist credit unions in their daily operations. Finally, in 1934 the last of CUNEB's objectives came to fruition with the formation of the Credit Union National Association (CUNA). Thus, by 1934, the credit union industry structure had obtained the basic form it would maintain for the next 45 years.

Bergengren and Filene, the two men so instrumental in organizing the credit union movement in the United States, held diverging views on the nature and function of cooperative credit. Bergengren, on the one hand, stressed the altruistic, cooperative nature of credit unions and their contribution to social stability and to the individual members' spiritual integrity. Filene, on the other hand, stressed that credit unions functioned as institutions of mass consumer finance that alleviated the danger of underconsumption in an economy predicated on mass-machine production. Filene's enormous influence on the movement notwithstanding, it was Bergengren's altruistic conception of credit unions which dominated credit union ideology.

According to Bergengren, the "basic idea" of credit unions was that common working people could organize themselves, pool their savings, and

cooperatively supply their own credit. By providing an alternative, relatively inexpensive source of credit, credit unions would eliminate usury and the social disruption caused by usury. In addition, credit unions would educate the masses in matters of thrift, financial independence, and "economic democracy". By promoting before all else their members' welfare and by educating them in "economic democracy", credit unions buttressed the political stability of democratic society. As institutions based on mutual self-help and cooperation, they contributed to the moral fiber of their members as well:

"In the business and human relations of the credit union we see a daily expression of spiritual values-- honesty, loyalty, tolerance, unselfishness, truthfulness, sympathy, faith and good will...The Ten Commandments and the Eleventh Commandment of Jesus to 'love thy neighbor as thyself' could well have been a part of the bylaws." (32)

In short, by attacking the evils of usury and continuing to meet their members financial, social, and moral needs, credit unions strengthened democratic society.

According to Bergengren, credit union management had to be primarily motivated by a genuine concern for a members' welfare and not by profit. Credit unions were conceived as "concerned" institutions, always prepared to lend to members in time of need, while taking care to ensure that members never fell into more debt than they could repay. Bergengren's description of credit union lending practices indicates the altruistic/paternalistic motivation underlying his conception of credit unions.

"The function of the credit union is to make loans to members as often as, and only to the degree that, will do them

the most good. This may mean a series of provident loans for sickness, dentist bills, the purchase of consumer goods. It may mean that repayment must be made prorated over a (long) period. In short, the credit union is always on hand to give helpful service. Always the starting point of the credit union is the welfare of the members, not greater business for increased profits." (33)

In spite of the time, effort, and money he contributed to the credit union movement, Edward Filene harbored no altruistic motivations. Filene supported credit unions because they fit into his overall conception of the economics of mass-production. Filene labeled the mass production system of his time the "machine age" and conceptualized it as follows:

"We must remember first that mass production is production for the masses. It is production motivated by the desire to sell the greatest possible quantities by giving the greatest possible values at the lowest possible cost to the greatest possible number of people." (34)

Mass production was a product of the capital accumulation of the "first industrial revolution." At that earlier stage of development, enlarging the productive base required minimal consumption from the masses and maximum saving on the part of all classes of society in order that the resulting surplus would be as large as possible which could be reinvested. Profit-maximization and the constant search for more efficient production methods led to the use of power machinery. The vast productivity of the new methods of production and the implications thereof, wrote Filene, were just being discovered. The "lust" for profit would prompt the adoption of the most recently developed mass production techniques.

"Because it is the most effective method, it is the most profitable method. Therefore it already dominates the market and must displace all the old traditional methods. The very 'lust for profits' makes this certain. Although not more than twenty-five per cent of production in America...has yet been organized under true mass production methods, it is only a question of time, and of a short time at that, when the bulk of

distribution will be carried on by mass production principles..." (35)

The revolution in production required and therefore would precipitate a pervasive reorganization of America's socio-economic life. Having created the basis for the "Second Industrial Revolution", the frugality of the previous period now required that the once-deprived masses become consumers:

"The great business need now...(is to) keep the machine going, and it could be kept going only if its products were sold. They could be sold, however, only if they could be bought, and the machine was so productive that it was necessary for the masses generally to buy and buy abundantly." (36)

In other words, the process of economic development had created both the potential for and the necessity of a heretofore unheard of phenomenon, namely mass consumption and, as a consequence, higher incomes and living standards. Mass production required employers to provide workers with higher wages and shorter work days; without these, working people could neither purchase nor consume additional goods. Mass production also required high levels of employment and income, sustained, if need be, through government-sponsored public works programs and unemployment compensation. As the costs of production fell, prices had to be lowered so that the additional output could be sold. Finally, consumers needed a means to finance their consumption. Whereas the earlier stage of industrialization emphasized saving and producers' credit, the viability of mass production required a means of financing consumption on a mass scale.

"But as it was once necessary for the old-fashioned storekeeper to extend credit to the sick and unfortunate to tide them over to better times...it has now become necessary for an organized, nation-wide financial system to see to it that some

temporary industrial dislocation does not result in such a lessening of buying power that the whole industrial system is eventually upset." (37)

In the absence of widespread consumer credit, the "second industrial revolution" would have floundered. Hence, although initially founded to combat usury, credit unions contributed to the economic growth and social stability of the U.S. by functioning as an institution of mass consumer finance.

The Early Development of Credit Unions

The first stage of credit union development covers the period from 1909 to 1934. As discussed, during the period 1909 to 1921, there was no sustained, systematic effort to organize credit unions on a national basis. Up to 1921, only a dozen states had enacted laws authorizing their formation. At the end of 1925, 23 states had done so. By 1934, however, many states as well as the Federal government had passed legislation authorizing the formation of credit unions.

Many of the early credit union leaders believed that credit union would soon displace other consumer lenders, and that credit unions would permanently solve the short-term credit problem of the masses. However, available data indicates that far from displacing other consumer credit agencies, credit unions merely became one among a number of consumer credit agencies in the market. As Table 3.2 indicates, credit unions remained a relatively small portion of the total consumer lending business. Consequently, credit unions, for the most part, were able to circumvent competitive market conditions.

TABLE 3.2

Consumer Loans Granted by Various Cash Lending Agencies
as a Percent of Total Loans Granted **

Year	Banks	Credit Unions	Industrial Banking Companies	Pawn- brokers	Regulated Loan Companies	Unregu- lated Lenders	Miscel- laneous Agencies
1923	63.4%	2.1%	9.2%	11.9%	6.7%	3.1%	3.6%
1924	61.4%	2.2%	10.5%	11.5%	7.4%	3.3%	3.7%
1925	61.4%	2.2%	11.4%	10.2%	8.2%	2.9%	3.7%
1926	59.7%	2.2%	12.9%	9.5%	9.3%	3.1%	3.2%
1927	57.7%	2.3%	13.7%	9.0%	11.5%	2.9%	2.9%
1928	57.1%	2.1%	13.7%	7.9%	13.7%	2.9%	2.7%
1929	55.9%	1.9%	13.3%	7.2%	15.9%	3.0%	2.8%
1930	52.8%	1.9%	13.6%	7.8%	18.0%	3.3%	2.5%
1931	46.3%	2.2%	14.2%	9.0%	22.2%	3.8%	2.2%
1932	41.6%	2.7%	14.5%	9.1%	26.1%	4.1%	1.8%
1933	39.0%	3.2%	14.3%	10.3%	27.4%	4.4%	1.5%
1934	41.5%	3.4%	13.4%	8.8%	26.3%	4.8%	1.6%

Source: Calculated from Rolf Nugent, Consumer Credit and Economic Stability, p. 115.

** These figures are estimates

Credit union loans were small in relation to other consumer lenders during this period; the average size of a credit union loan was much smaller than the average loan size granted by other consumer credit agencies. This can be attributed to the fact that since most credit union members earned relatively small incomes their debt limit was relatively low.

In general, the greatest progress occurred among credit unions organized around industrial and governmental employee groups. (38) The close community of interest among workers of the same employer or factory provided the associated credit union with a sense of viability that was

unmatched by community, associational, and other types of credit unions. As will be discussed in later chapter, this condition nurtured credit union growth, it also led to the most dramatic crisis in American credit union history. Table 3.3 provides estimates, made by the Credit Union Extension Bureau in 1929, which reveal how heavily the distribution of credit unions is skewed toward occupationally-based credit unions.

Table 3.3

Distribution of Credit Union Assets
as a Percentage of Total Assets

Industrial	40%
Government and Public Utilities	31%
Community	20%
Labor Unions	5%
Social Organizations	2%
Rural	1%
Religious	1%

Source: Evans Clark, Financing The Consumer, p. 90.

The effectiveness of credit unions as a financial institution serving people with modest means (e.g., factory workers, poor immigrants, etc.), was indicative of the rapid growth of the movement. The greater part of credit union development occurred between 1920 and 1925. For the most part, credit union growth by state paralleled the enactment of credit union legislation in the various states during the 1920s.

The following table chronologically lists the enactment of state credit union laws and the maximum interest rate allowable and maximum loan limits available to members:

TABLE 3.4

Digest of Credit Union Laws

State	Law Enacted	Maximum Interest	Maximum Loan	
			wo/security	w/security
Massachusetts	1909	Reasonable	\$100	
New York	1913	1% a month	\$50	\$2000
Texas	1913	Reasonable	\$1000	
Wisconsin	1913	1% a month		Over \$50
Rhode Island	1914	Reasonable	Set by Board	
North Carolina	1915	Legal limit	\$50	
Oregon	1915	1% a month	\$50	
South Carolina	1915	7% a year	No Limit	
Utah	1915	12% a year		\$3000
Nebraska	1919	Legal limit	\$50	
New Hampshire	1921	Legal limit	By-Laws	
Virginia	1921	1.5% a month	\$50	
Kentucky	1922	Reasonable	\$50	
Indiana	1923	8% a year	\$50	
Tennessee	1923	Reasonable	\$50	Set by Board
Louisiana	1924	1% a month		\$500
Mississippi	1924	1% a month	By-Laws	
New Jersey	1924	1% a month	\$50	\$500
Georgia	1925	1% a month	None	
Illinois	1925	1% a month	\$50	\$1000
Iowa	1925	1% a month	By-Laws	
Michigan	1925	1% a month	No Limits	
Minnesota	1925	1% a month	Set by Board	
West Virginia	1925	1.5% a month	\$50	
Alabama	1927	1% a month	By-Laws	
California	1927	1% a month	\$100	\$2000
Missouri	1927	1% a month	\$50	\$1000
Arizona	1929	1% a month	None	
Florida	1929	1% a month	None	
Kansas	1929	1% a month	\$50	\$1000
Maryland	1929	1% a month	\$50	
Montana	1929	1% a month	None	
Arkansas	1931	10% a year		\$1000
Colorado	1931	1% a month	None	
Ohio	1931	1% a month	\$50	None
District of Columbia	1932	1% a month	\$50	No Limit
Oklahoma	1933	10% a year	None	
Pennsylvania	1933	1% a month	By-Laws	
Washington	1933	12% a year	\$50	\$2000
Idaho	1935	1% a month	None	
North Dakota	1935	1% a month	No Unsecured	
South Dakota	1935	1% a month	\$50	\$1000

Source: Charles Hardy, ed., Consumer Credit And Its Uses, p. 177.

Of the 284 credit unions operating in 1925, 71 percent were in Massachusetts and New York alone. This coincides with the trend in U.S. industrial development. As discussed in Chapter Two, the bulk of U.S. industrial development occurred in New England (primarily in Massachusetts and New York), and no more than 100 miles off the coast of the Atlantic Ocean.

With respect to credit union members, total membership reported numbered 107,799, of whom 45,672 were in Massachusetts, 47,783 were in New York, and 6,510 in Rhode Island. (As a percent of total credit union membership, the combined figures of Massachusetts and New York accounted for nearly 87 percent of all credit union members.) The credit unions in these states had an average membership per credit union of 787, 713, and 1,628, respectively. Table 3.5 shows the membership distribution and the average membership level per credit union categorized by State at the end of 1925

TABLE 3.5

Membership of Credit Unions At The End of 1925, by State

STATE	MEMBERS		STATE	MEMBERS	
	Number	Average		Number	Average
Arkansas	390	390	North Carolina	561	56
California	117	117	Oklahoma	240	120
Florida	215	215	Pennsylvania	350	350
Georgia	214	214	Rhode Island	6,510	1,628
Indiana	841	120	South Carolina	96	96
Iowa	47	47	Tennessee	269	90
Kansas	61	61	Texas	41	41
Kentucky	480	240	Virginia	608	152
Louisiana	265	265	Washington	235	235
Maryland	173	173	West Virginia	62	62
Massachusetts	45,672	787	Wisconsin	495	495
Minnesota	395	395			
New Jersey	1,659	415			
New York	47,783	713	TOTAL	107,799	612

Source: Monthly Labor Review, November 1926.

By 1932, Massachusetts still held the leading place in terms of credit union development, with New York following closely behind. Missouri, which according to the records of CUNEB had not a single credit union in 1929, had a greater number of credit unions than New York at the end of 1932. Illinois was also becoming another important state in terms of credit union growth. While in Rhode Island, there were a relatively small number of credit unions, assets on average were far in excess of those in Massachusetts or New York. In sharp contrast, North Carolina, which had credit unions since 1919, did not experience substantial credit union growth. These facts appear to correlate with the distribution of economic activity as outlined in the first section of this chapter, and substantiates the point that credit union growth was best achieved in areas with a strong industrial/economic foundation.

With respect to aggregate credit union growth, the following table provides a comparative analysis of credit union growth for 1929, 1932, 1933, and 1934. While the number of credit unions, total members, and reserves increased steadily from year to year, average membership, average share capital, and the total and average amount of loans granted revealed large declines. (The latter movements are for the most part directly attributable to the events surrounding the economic depression of the 1930's.)

TABLE 3.6

Comparative Development of Credit Unions, 1929, 1932, 1933, and 1934

Item	1929	1932	1933	1934
Total number of unions	974	1,612	*****	*****
Number reported for	838	1,472	1,172	2,028
Total Membership	264,908	301,119	359,646	427,097
Average per union	320	216	215	234
Share Capital	\$24,065,407	\$21,708,328	\$22,457,861	\$26,285,497
Average per member	\$92	\$70	\$62	\$58
Reserves/Guaranty fund	\$2,079,450	\$2,110,815	\$2,372,211	\$2,618,587
Loans during year	\$24,548,353	\$16,375,952	\$28,217,457	\$29,580,684
Average per union	\$58,310	\$16,475	\$22,811	\$23,310
Average per loan	\$350	\$156	\$138	\$177
Loans outstanding	\$30,811,582	\$24,826,291	\$26,391,683	\$28,033,581

Source: Monthly Labor Review, October 1935

Why Credit Union Members Borrow

A 1925 study of 6 credit unions in the Boston area showed the most common expenditures for which credit union loans were made. (39) In general, loans for medical expenses, coal, family expenses, "various bills", and clothing formed four-fifths of the total number of loans granted. Credit union members most frequently borrowed to pay for medical expenses incurred during an illness. Of the total loans made, 23.2 percent

were for medical reasons. The next most frequent purpose for borrowing was to purchase coal as 15.5 percent of total loans were extended to finance that expenditure. Just over eleven percent of total loans were used to cover family expenses, which included the purchase of such household items as kitchen stoves and new tires for the family car. The category "various bills" is next, with clothing closely behind. The following table shows the distribution of loans by type as a percent of total loans granted

TABLE 3.7

Purposes For Which Loans Were Granted

Purpose of Loan	Number	Percent
Medical	929	23.2%
Coal	618	15.5%
Family Expenses	451	11.3%
Clothing	341	8.5%
Investment	323	8.1%
Various Bills	322	8.1%
House repairs/payments	302	7.6%
Taxes	208	5.2%
All other	93	2.3%
Furniture	90	2.3%
Renewels	61	1.5%
Education	59	1.5%
Insurance	57	1.4%
Vacation	57	1.4%
Automobiles	39	1.0%
Death	20	.5%
To pay notes	19	.5%
No data	8	.2%
Radios	3	.1%
Total	4,000	100.0%

Source Monthly Labor Review, July 1927.

These loans, in the author's words, were made "to satisfy current and emergency needs-to enable the borrowers to keep their heads above water". These loan patterns, although not conclusive evidence, indicate that

credit unions did in practice provide one of the two services for which they were founded, i.e., to provide credit to people who are independent but who have no margin of savings and hence no means of meeting emergency expenditures.

As will be detailed in the following chapters, before the end of World War II, not including the years of the depression, credit union members borrowed chiefly when they were in distress, such as for a medical emergency or unemployment. Therefore, as business activity subsided, the volume of credit union loans generally rose, or decreased less dramatically. After World War II, the sustained economic expansion and the proliferation of a mass of consumer goods turned this situation about, as credit union members increasingly borrowed to expand purchasing power during periods of economic expansion, and borrowed less during periods of economic contraction.

Footnotes

(1) Alvin Hansen, Business Cycles and National Income, (W. W. Norton & Co., 1951), pp. 30-31.

(2) Ibid., p. 74. Investment in streetcars peaked during the decade from 1900 to 1909. Capital outlays on telephones doubled during the first two decades of the twentieth century. Investment in electric power reached \$5.4 billion during the decade from 1900 to 1909, and increased by fifty percent during the following decade and attained a level of \$8.1 billion during the decade of the 1920s. Automobile production rose from 4,000 units in 1900 to 187,000 units in 1910, to 2.2 million units in 1920, and 5.6 million by 1929.

(3) Albert W. Niemi, U.S. Economic History: A Survey Of The Major Issues, (Rand McNally College Publishing Company, 1975), Table 16.2, p. 260.

(4) The Federal Reserve Banks controlled and coordinated credit and money creation at the regional and national levels. The Federal Reserve could influence the supply of money through its various policy instruments, such as open market operations. Banks in capital-starved regions could borrow from the Federal Reserve Bank, thus improving the regional distribution of credit. The Federal Reserve Bank also acted as a national clearinghouse for checks and greatly increased the speed of business transactions. The powers of the Federal Reserve were broadened as a result of the collapse of the banking system during the Great Depression. For more on the Federal Reserve System, see The Federal Reserve System, (The Board of Governors of the Federal Reserve System, 1961). For a more concise treatment, see Paul A. Samuelson, Economics, 9th edition, (McGraw Hill, 1973), Chapter 17.

(5) Historical Statistics, Part 1, Series D 127-141, p. 137.

(6) Ibid., Part 2, Series D 17, p. 458.

(7) Ibid., Part 1, Series F 251, 254, 259, p. 240.

(8) Ibid., Part 1, Series D 167, 170, 174, p. 139.

(9) Ibid., Part 1, Series A 119, p. 15.

(10) Ibid., Part 1, Series C 89, p. 110.

(11) Ibid., Part 1, Series A 57, p. 11-12.

(12) Ibid., Part 1, Series F 3-4, p. 224.

(13) For an analysis of this development, see The Underside of American History, Thomas R. Frazier, ed., (Harcourt Brace Jovanovich, 1978), Chapters 1 and 2. See also, Louis M. Hacker, The Triumph Of American Capitalism, (Columbia University Press, 1940), Chapter 20.

(14) Thomas Cochran, 200 Hundred Years of American Business, (Dell Publishing, 1977), Chapter 9. See also, Alfred D. Chandler, Jr., "The

Beginnings of Big Business in American Industry," Business History Review, Spring 1959. For a quantitative assessment, see Historical Statistics, Part 2, Series P214, p. 668.

(15) John O. Sullivan and Edward F. Keuchel, American Economic History: From Abundance To Constraint, (Franklin Watts, 1981), pp. 119-121.

(16) The following analysis is based upon the work done Rolf Nugent in his Consumer Credit and Economic Stability, (Russell Sage Foundation, 1939).

(17) Ibid., p. 47.

(18) Ibid., p. 48.

(19) Ibid., p. 54.

(20) Unlike other consumer lenders, pawnbrokers did not accept promissory notes to repay loans. This convention remains the same today. The pawnbroker's claim extends solely against the property pledged. The transactions represent essentially the conditional purchase of personal property. For more on pawnbrokers see, Evans Clark, Financing The Consumer, (Harper & Brothers, 1930), pp. 40-44.

(21) Rolf Nugent, Consumer Credit and Economic Stability (Russell Sage Foundation, 1939), Chapter 3.

(22) Ibid., pp. 66-71.

(23) For a vivid description of the loan shark racket see, Richard Y. Giles, Credit For The Millions, (Harper & Brothers, 1951), Chapter 1. For a more formal treatment see, Consumer Credit And Its Uses, Charles O. Hardy, ed., (Prentice Hall, 1938), Chapter 7; and Evans Clark, Financing The Consumer, (Harper & Brothers, 1930), pp. 32-39.

(24) Consumer Credit And Its Uses, Charles O. Hardy, ed., (Prentice Hall, 1938), Chapter 6; and Evans Clark, Financing The Consumer, (Harper & Brothers, 1930), pp. 101-106.

(25) John M. Glenn, Lillian Brandt, and F. E. Andrews, Russell Sage Foundation: 1907-1946, (Russell Sage Foundation, 1947).

(26) The text of the "Uniform Small Loan Law" is contained in Evans Clark, Financing The Consumer, (Harper & Brothers, 1930), pp. 264-271.

(27) Rolf Nugent, Consumer Credit and Economic Stability, (Russell Sage Foundation, 1939), pp. 78-80.

(28) Peter W. Herzog, The Morris Plan of Industrial Banking, (A. W. Shaw, 1928). See also Evans Clark, Financing The Consumer, (Harper & Brothers, 1930), pp. 62-72.

(29) The following analysis of the emergence and early development of cooperative credit is from J. Carrol Moody and Gilbert C. Fite, The Credit Union Movement: Origins and Development, 1850-1970, (University of Nebraska Press, 1971), Chapters 1, 2, and 3.

(30) In promoting thrift rather than assembling credit, American credit unions reflected the industrial based nature of the American economy. In contrast to the European situation where credit cooperatives were formed to assist the small producer, in America credit cooperatives were formed to assist the working class.

(31) For background information on Edward A. Filene, see the introduction by Glenn Frank in Successful Living in this Machine Age, Edward A. Filene, (Simon and Schuster, 1932).

(32) Roy F. Bergengren, Crusade, (Exposition Press, 1952), p. 33.

(33) Ibid., p. 27.

(34) Edward A. Filene, Successful Living in this Machine Age (Simon and Schuster, 1932), with an introduction by Glenn Frank, p. 11.

(35) Ibid., p. 10.

(36) Ibid., p. 44.

(37) Ibid., pp. 50-51.

(38) While credit union growth can better be classified and measured in terms of economic groups than by geographical divisions, the lack of data compels analysis in this chapter to be along geographic lines.

(39) U.S. Bureau of Labor Statistics, John Mildred, "Why Workers Borrow: A Study of Four Thousand Credit Union Loans," Monthly Labor Review, July 1927.

CHAPTER FOUR

Credit Union Growth and Maturity: 1920-1945

The last chapter pinpointed mass scale production as that aspect of American economic development which led to the creation of a class of urban wage and salary earners. The development of a consumer goods market corresponded to the development of mass scale production, as did the nascent forms of consumer finance which appeared in the late 19th-early 20th century. (1)

By the decade of the 1920s, American economic development reached maturity, as continued technological innovation allowed at last the fruition of a large-scale consumer goods markets. During the 1920s, sales of consumer durables emerged on a mass scale for the first time in American history. The financial services sector did not escape the transformation in American life as a market in consumer financial services appeared during the 1920s. The extraordinary circumstances of the Great Depression and World War II interrupted the further development of these trends. Only after the cessation of the war would a significant market in consumer goods and in consumer finance reappear.

In studying the development of credit unions from 1920 until 1945, the current chapter adopts much the same methodology as the chapters which precede it. The historical development of the U.S. economy--in both quantitative and qualitative terms--provides the general context for the study of financial markets in general and credit unions in particular. The chapter covers the period stretching from the 1920s, the dawn of the high-consumption society, through the collapse and retrenchment of the

economy as a result of the Great Depression and through, finally, the dislocations caused by World War II. As occupational credit unions have dominated credit union history, the section on the United States economy is analyzed in terms of sectoral performance with respect to national income, employment, and wages over the period under review.

Within this general economic context, the dissertation then turns to developments in financial markets as these developments affected financial depositories. Since banks were dominant among depositories, financial market conditions are described from the perspective of the experience of commercial banks, in terms of both philosophic and operational changes. It was these philosophic and operational changes which were the most striking development among banks with respect to innovative activity in consumer financial markets during the 1920s. As commercial loans stagnated, commercial banks reluctantly entered the consumer financial services market. This entry entailed new banking practices and a corresponding change in banking philosophy which was coincidental with the emergence of a consumer society of the 1920s.

At the market level, fierce competition between depositories ensued the encroachment of banks into consumer finance. This competitive struggle induced new pricing practices and the development of new products and services. Public response to the financial collapse during the Great Depression took the form of banking reform, which, coupled with the general economic collapse, interrupted innovative activity. The restrictive conditions which prevailed during World War II also precluded innovative activity. As the following chapters will show, economic and financial

market conditions would elicit fierce competition between financial institutions, both depositories and nondepositories, again in the 1960s and 1970s. As such competition intensified, many of the practices and services first developed in the 1920s reappeared, albeit, in new advanced forms. (2)

As the most reliable and comprehensive credit union data during the 1920s pertained to Massachusetts credit unions, the analysis of credit unions focuses initially on the performance of those credit unions during the 1920s and during the early years of the Great Depression. The focus then shifts to federal credit unions, the organization of which began following the enactment of enabling legislation in 1934. This and future chapters will examine the development of federally-chartered credit unions.

The early federal credit unions were organized primarily around occupational groups and they grew rapidly both in number and in average size. Possible explanations for their performance amidst general economic stagnation are to be found in the conditions which existed at their founding. First, commercial bank entry into consumer financial services had contracted as a result of the Great Depression. Second, these early Federal credit unions were organized among the employed. Third, their organization postdated the terrible contraction of 1929-1933. The conditions of financial markets coupled with the regulatory structure which was constructed, permitted credit unions to grow and prosper under the umbrella of infant industry protection. (3)

The Economy

Contrary to fears that a severe depression would follow World War I, from 1918 to 1920 the economy experienced an inflationary boom. Fueled by rapid monetary expansion, a surge in construction activity, and speculation, the economy experienced high employment levels, rising price levels, and considerable stock market activity. In spite of rapid demobilization the federal government continued to run a sizeable deficit. Until late 1919, the Treasury borrowed extensively in order to extend war recovery loans to the Allies, while the Federal Reserve was obliged to accommodate the Treasury's borrowing. Inventory accumulation and increases in demand for housing fueled aggregate demand. Housing shortages which emerged during the war led to brisk residential building construction immediately after the war. Finally, between 1918 and 1920, exports of food and other goods to Europe stimulated production in the United States. U.S. merchandise exports rose from \$6.4 billion in 1918 to \$8.4 billion in 1920, with a large volume of exports in machinery, durable production equipment, and railroad locomotives. (4)

The post-war boom ended in mid-1920 as a series of factors curtailed growth in aggregate demand. First, government spending fell sharply, from \$18.5 billion in 1919 to \$6.4 billion in 1920, and the federal budget moved from a deficit of almost \$9 billion in 1919 to a surplus of \$831 million by the end of 1920. Second, as agricultural and industrial production resumed in Europe, demand for U.S. exports sagged, leading to sharp reductions in the value of farm goods and raw materials. Third, falling prices stimulated rapid inventory decumulation. Inventory shrinkage was further

exacerbated by the fact that bank credit tightened as the Federal Reserve raised the discount rate in late 1919. In short, the severe cuts in government spending, the sharp declines in demand for both farm products and raw material exports, and the rapid inventory reductions coupled with tight monetary policy resulted in a short, but sharp recession in 1921. (5)

As the 1920-21 recession deepened, the unemployment rate grew from 1.4 percent in 1919 to 5.2 percent in 1920 and then more than doubled to 11.7 percent by 1921. Real GNP fell from \$140 billion to \$127.8 billion in 1921 dollars, as both consumption expenditures and inventory investment fell sharply. By midsummer 1921, the contraction had run its course and a marked recovery was underway by 1922.

In real terms, from 1921-1929, the economy expanded vigorously, interrupted only by the minor recessions of 1924 and 1927. Real GNP and per capita GNP, for example, rose 45 percent and 27 percent, respectively, between 1920 and 1929. Unemployment fell as low as 1.8 percent of the civilian labor force in 1926. Hourly wages remained relatively stable in spite of full employment conditions. Combined with rising productivity, wage stability made possible nearly zero inflation, as the wholesale and consumer price indices remained stable, showing little annual change.

The prosperity of the 1920s was marked by brisk investment. For example, the value of producers' durables rose from \$3,222 million in 1921 to \$6,230 million in 1929. The value of industrial machinery, tools and equipment rose from \$1,094 million in 1921 to \$2,210 million in 1929, an increase of over 100 percent. Another notable characteristic of the

expansion was the impressive productivity gains and increased utilization of electrically-powered machinery in manufacturing. Between 1923 and 1929, electrical power consumption in manufacturing increased 70 percent, which permitted tremendous increases in output accompanied by lesser growth in the labor force. Thus, whereas GNP increased 45 percent from 1921 to 1929, over the same period the estimated civilian labor force increased only 13.8 percent. (6)

Output of consumer goods displayed relatively buoyant growth, though less so than the output of investment goods. (7) Over the period from 1921 to 1929, output of consumer durables increased 99 percent, from \$3,196 million in 1921 to \$6,361 million in 1929. Indeed, Rostow and others refer to the 1920s as the beginning of mass-market consumption in the United States. (8) During this period, automobile sales rose from less than 2 million in 1920 to almost 4.5 million in 1929. Residential consumption of electricity tripled between 1920 and 1929 as household appliances, such as refrigerators and radios, became readily available. In 1922, only 60,000 homes had radios, whereas by 1929 the number of radios climbed to over 10 million. However, in contrast, the output of consumer perishable and semi-durable goods grew more slowly, increasing by a third from \$19,164 million in 1921 to \$25,515 million in 1929. (9)

Growth in per capita income not only indicated substantial gains in productivity but reflected as well a slowing in the rate of population growth. During the decade of the 1920s, the population of the United States grew by some 16 million, from roughly 106 million inhabitants in 1920 to 123 million inhabitants by 1930. That relatively low rate of

population growth, roughly 13 percent, was mainly the result of a substantial slowing in the rate of migration to the United States. (10)

The most striking demographic transformations were, first, the continuing move from rural farm to the urban industrial centers, and second, the emergence and growth of suburban areas. The farm population declined 1.2 million during the 1920s, and the nonfarm rural population rose slightly. In stark contrast, cities with populations in excess of 2,500 gained over 14.7 million inhabitants during the same decade. The 1920s marked the beginning of a mass movement out of the urban industrial areas and into the surrounding suburbs. (11)

In the stock market, extensive speculation inflated stock prices during the latter half of the 1920s. Between 1926 and 1929, average prices of common stock doubled. The Dow-Jones Industrial Average rose from a high of 120.5 in 1924 to 159.3 in 1925, climbed to 166.6 in 1926, jumped to 202.4 in 1927, soared to 300 in 1928 and peaked at 381 on September 3, 1929. (12)

By the fall of 1929, weakness in the stock market manifested itself in sagging security prices. While this slippage was discounted as being no more than a minor adjustment, a number of "breaks" occurred as stock prices fell and culminated in the great crash of October 24, which became known as "Black Thursday". (13) For the next three years, security prices followed a downward trend as the economy entered the most destructive economic depression in the history of United States. By 1932, the Dow-Jones Industrial Average stood at 41, little more than 10 percent of its September 1929 peak of 381. The downturn affected shares in even the

strongest companies: United States Steel fell from 262 to 22; General Motors dropped from 73 to 8; and Montgomery Ward plummeted from 138 to 4.

All principle measures of economic activity reflect the severity of the Great Depression. National income valued in 1958 prices fell by more than one-half from \$86.8 billion in 1929 to \$40.3 billion in 1933, as the contraction reached its lowpoint. The Federal Reserve index of manufacturing production fell by nearly one-half (from 100 to 52) between 1929 and 1932. Private capital formation fell from \$16.2 billion in 1929 to \$900 million in 1932. Also, the number of unemployed grew from 1.5 million (8.9 percent of the labor force) in 1930 to 8 million (16.3 percent of the labor force) in 1931, to 12 million in 1932 (24.1 percent of the labor force and more than one-third of all non-farm employees). (14)

National Income

The extent of the 1929-33 contraction in specific sectors of the economy is reflected in Table 4.1, where national income is viewed as the sum of income generated by payments for labor, capital and natural resources in each sector. The severity of the contraction, which lasted from 1929 until 1933, is reflected in sharply declining income levels generated in each sector, with the sole exception being the public sector. National income generated in the public sector increased over 23 percent, a reflection of the expanded use of fiscal measures as an attempt to mitigate the severity of the contraction. Excluding the government sector, the aggregate decline in sectoral income averaged roughly 46 percent.

The decline was most severe in contract construction. Expenditures on new construction, valued in 1929 dollars, fell from \$11,193 million in 1929 to \$3,673 in 1933, a decline of 67 percent. This severe contraction was reflected in a 71 percent decline in the share of national income generated by contract construction. Income generated in the communications and public utilities sectors dropped least sharply, as major industries composing this group experienced less dramatic a decline in activity. Electric and gas consumption, for example, dropped 14 percent and 8 percent, respectively, between 1929 and 1933. Output of telephone companies (measured in terms of number of calls per year) fell 17 percent and of the telegraph industry (measured in terms of messages handled per year) dropped 39 percent over the same period. The number of AM radio stations fell only 3.2 percent. (15)

By 1933, the depression bottomed out and between 1934 and 1939 national income grew 46.7 percent. Table 4.1 reveals considerable recovery in all sectors from 1934 to 1939. During that time, recovery was most brisk in construction activity (which experienced an increase of over 109 percent) and in manufacturing (in which income rose more than 60 percent). Growth in income generated by communications, services, and the government sector proceeded most slowly, but still at a considerable rate. Between 1934 and 1939, income increased 27.3 percent in communications/public utilities, 31.0 percent in the services category, and 34.9 percent in the public sector. As can be calculated from Table 4.1, the mean growth rate of income between 1934 and 1939 was approximately 48.4 percent. These growth rates, however, must be interpreted in light of the relatively low levels of national income from which recovery began. Most industries did

not regain their pre-1930 levels of income until the outbreak of World War II.

Table 4.1

Rate of Growth of National Income, by Sectors

Sector	1929-34	1934-39	1939-45
Agriculture/Forestry/Fisheries	-50.6%	42.9%	153.3%
Mining	-47.6%	45.5%	75.0%
Construction	-71.1%	109.1%	87.0%
Manufacturing	-49.3%	63.1%	188.4%
Wholesale/Retail Trade	-38.5%	51.8%	122.2%
Finance/Insurance/Real Estate	-56.3%	42.9%	62.5%
Transportation	-48.5%	35.3%	128.3%
Communications/Public Utilities	-21.4%	27.3%	50.0%
Services	-34.1%	31.0%	85.5%
Government/Government Enterprise	23.5%	34.9%	332.9%

Source: Computed from Historical Statistics, Series F 226-237, p. 239.

Following the downturn of 1937-38, the economy proceeded along an unsteady recovery path until 1940. With the entry of the United States into the Second World War, however, the economy reached a vigorous expansion phase. Stimulated by the necessities of war, production and employment rose rapidly. The rate of unemployment fell from 15 percent in 1940 to 9.9 percent in 1941. It continued to fall throughout the war and by 1944 the unemployment rate stood at 1.2 percent of the civilian labor force. In stark contrast to the 1930s, labor shortages and inflation replaced unemployment and excess productive capacity as the most pressing problems during World War II.

As the economy edged toward full-capacity (maximum resource utilization), most sectors experienced considerable growth as evidenced in Table 4.1 and in Table 4.2 below. The mean rate of growth of sectoral income exceeded 120 percent over the war period. Income in the government sector increased almost 333 percent between 1939 and 1945 as a consequence of military mobilization and war production. The public sector share of national income grew from almost 12 percent in 1935 to over 20 percent by 1945. This rising income share of the public sector during the war years reflects, of course, the rising proportion of productive resources dedicated to the war effort.

If the extraordinary growth of the government sector is excluded, the mean income growth by sector was roughly 105 percent. The expansion was most vigorous in war-related industries. The aviation industry, for example, boomed during the war, as the number of airplanes produced increased from 5,856 in 1939 to 95,272 in 1944. (16) Income generated by production in the manufacturing and transportation sectors also grew above the average rate. In the agricultural sector, war-related demands for food generated increased farm output and prices. Income generated in agriculture/forestry/fisheries increased 153 percent and the secular decline in that sectors' share of national income temporarily reversed.

Growth in other sectors was restrained by wartime controls. Over the course of World War II, for example, expenditures on new construction (valued in 1929 dollars) rose from \$9,065 million in 1940 to a wartime high of \$12,115 million in 1942 and stood at \$4,836 million in 1945. Moreover, most of the activity consisted of public construction. Expenditures on new

private residential construction fell from \$2,846 million in 1940 to a low of \$790 million in 1944. Between 1940 and 1944, expenditures on new nonresidential construction fell from \$2,175 million to \$1,636 million. (17) Consequently, the construction sector experienced relatively low income growth during the war and its share of national income declined.

Growth in sectoral income tapered off during the last two years of World War II with declines being exhibited in the construction and manufacturing sectors' income. Construction income fell 15.4 percent in 1943 and over 25 percent in 1944; while income in manufacturing declined 13.4 percent in 1945 and 5.9 percent in 1946. The transportation sector experienced small declines in income in 1945 and 1946; government sector income dropped drastically (over 38 percent in 1946 and more than 17 percent in 1947) immediately following the War.

Table 4.2

Percentage Distribution of National Income, by Sector, 1929-1945

Sector	1929	1934	1939	1945
Agriculture/Forestry/Fisheries	9.8%	8.5%	8.3%	8.4%
Mining	2.4%	2.2%	2.2%	1.5%
Construction	4.4%	2.2%	3.2%	2.4%
Manufacturing	25.2%	22.4%	24.9%	28.8%
Wholesale/Retail Trade	15.6%	16.8%	17.4%	15.4%
Finance/Insurance/Real Estate	14.7%	11.3%	11.0%	7.2%
Transportation	7.6%	6.9%	6.3%	5.8%
Communication/Public Utilities	3.2%	4.4%	3.9%	2.3%
Services	10.1%	11.7%	10.5%	7.8%
Government/Government Enterprises	5.9%	12.7%	11.7%	20.3%

Source: Computed from Historical Statistics, Series F 226-237, p. 239.

Although manufacturing remained the single most important sector in the economy, its share of national income fell steadily during the general economic contraction from 1929 to 1933. As aggregate economic activity improved following the Depression, the manufacturing sector's share of national income increased.

Table 4.2 shows a significant increase in the share of national income generated by the public sector. The income share of the government sector rose steadily as the economy contracted from 1929 until 1933, then

fluctuated between 10 and 12 percent between 1934 and 1942, and increased as the United States entered the second World War.

Employment and Labor Earnings

The growth and distribution of national income by sector found its counterpart in sectoral employment patterns. Employment in the nonagricultural sectors and shifts in employment patterns are shown in Tables 4.3 and 4.4.

Table 4.3
Percentage Growth of Nonagricultural Employment *

Sector	1929-1933	1934-1940	1941-1945
Mining	-31.6%	4.8%	-12.64%
Construction	-45.9%	50.1%	-36.8%
Manufacturing	-30.9%	29.2%	17.7%
Wholesale/Retail Trade	-22.3%	27.8%	1.4%
Finance/Insurance/Real Estate	-14.2%	13.9%	-3.4%
Trans/Comm/Util	-31.8%	10.5%	19.3%
Services	-16.5%	20.4%	8.2%
Government/Government Enterprises *	3.3%	27.4%	27.6%

Source: Computed from Historical Statistics, Series D 127-141, p. 137.

* The data recorded in Tables 4.3 and 4.4 reflect both part-time and full-time jobs generated in each sector.

Table 4.4

Percentage Distribution of Nonagricultural Employment

Sector	1929	1934	1939	1945
Mining	3.5%	3.4%	2.8%	2.1%
Construction	4.8%	3.3%	3.8%	2.8%
Manufacturing	34.1%	32.8%	33.6%	38.4%
Wholesale/Retail Trade	19.5%	20.3%	21.0%	18.1%
Finance/Insurance/Real Estate	4.8%	5.1%	4.8%	3.7%
Trans/Comm/Util	12.5%	10.6%	9.6%	9.7%
Services	11.0%	11.8%	11.5%	10.5%
Government/Government Enterprises*	9.8%	12.7%	13.0%	14.7%

Source: Computed from Historical Statistics, Series D 127-141, p. 137.

* Governmental employment covers civilian employees only.

The growing involvement of the federal government in the macroeconomy and entry into World War II was reflected in above-average growth in public sector jobs. Contrary to the experience in all other sectors, jobs in the public sector increased slightly during the severe economic contraction of 1929-33. During the late 1930s, as New Deal make-work schemes were implemented (e.g., the Civil Works Administration, the Works Progress Administration, the Civilian Conservation Corps, etc.), public sector employment grew over 27 percent and the government's share of nonagricultural employment rose to 13 percent by 1939. As the United States entered World War II, labor resources were allocated toward the public sector and toward war-related production.

During the late 1920s/early 1930s, employment declined most steeply in construction (over 45 percent) and fell by roughly 31 percent in mining, manufacturing, and the combined transportation/communication/public utilities sectors. For the remainder of the decade, employment in all nonagricultural sectors improved, most notably in construction, manufacturing, and the wholesale/retail trades. Consequently, the share of employment in these sectors rose between 1934 and 1939.

Throughout the entire period, mining and financial services accounted for a small and steadily dwindling proportion of nonfarm labor employment. The employment share of the combined transportation/communications/public utilities sector fell steadily to a low of 8.6 percent in 1942-1943 and then stabilized at roughly 9 percent of nonfarm employment for the remainder of the decade. From 1929 until 1941, the employment share of the service sector fluctuated between 11 and 12 percent; in 1941, its share fell to 10.7 percent, and then dropped to a low of 9.8 percent in 1943, reflecting a shift of labor-resources to war-related manufacturing industries. By 1946, the share of labor employed in the service sector returned to 11 percent.

From 1929 until 1940, the manufacturing sector accounted for roughly one-third of nonagricultural employment, and with the entry of the United States into World War II, that figure increased sharply to a peak of roughly 41.5 percent of nonfarm employment in 1945 and 1946. For the remainder of the 1940s, the employment share of the manufacturing sector returned to its pre-World War II level.

Table 4.5 shows the percentage change in average annual earnings by employment sector during the period from 1929 until 1945. During the years 1929 to 1934, there occurred considerable reductions in annual income. The decline in annual full-time employee earnings was most pronounced in construction (43.8 percent decline), the primary industries (37.0 percent decline), and mining (27.4 percent decline). Employees in the communications/public utilities sector, the transportation sector and the government sector suffered the smallest declines in their annual income (3.7 percent, 15.2 percent and 17.2 percent, respectively). (18)

Table 4.5

Rate of Growth of Annual Average Earnings,
per Full-Time Employee, by Sector: 1929-1945

Sector	1929-34	1934-39	1929-45
Agriculture/Forestry/Fisheries	-37.0%	52.2%	192.3%
Mining	-27.4%	23.4%	91.7%
Construction	-43.8%	34.6%	105.0%
Manufacturing	-25.3%	18.2%	84.7%
Wholesale/Retail Trade	-25.8%	15.0%	55.1%
Finance/Insurance/Real Estate	-22.4%	8.0%	36.0%
Transportation	-15.2%	23.7%	58.7%
Communications/Public Utilities	-3.7%	18.8%	44.6%
Services	-20.6%	11.1%	77.0%
Government/Gov. Enterprise *	-17.2%	4.1%	53.5%

Source: Computed from Historical Statistics, Part 1, Series D 739, 740, 741 753, 754, 755, 761, pp. 166-167.

* Civilian public sector workforce only.

Table 4.5 indicates even greater growth in average annual earnings between 1939 and 1945. The demands of defense production and military service provoked labor shortages, causing both wages and hours worked to increase. Average weekly hours and average hourly pay for production workers in manufacturing, for example, rose from 38.1 hours per week at \$.66 per hour in 1940 to 43.5 hours per week at \$1.02 per hour in 1945. In the aggregate, wages and salaries more than doubled between 1941, when they totalled \$62.1 billion, and 1945, when they reached \$117.5 billion. (19) Workers in agriculture, construction, and manufacturing experienced the largest increases in annual income.

In short, the demands of World War II produced dramatic changes in the U.S. economy. The three major changes that occurred were: the economy was operating at nearly full capacity with respect to labor and capital resources; significant levels of pent-up aggregate demand had developed during the years of forced saving and deferred expenditures on durable consumer and producer goods; and the financial condition of households and firms had improved markedly.

The Structure of Financial Markets

Throughout the 19th and into the 20th centuries, commercial banks set the tone for the financial system as a whole. Thus, the following analysis focuses upon the development of commercial banking during the period from 1920 to 1945.

The banking system of the 1920s consisted of a host of national and state banks, some large and powerful, others small and financially weak. Unlike other industrial nations, in which a few strong banks operated, a large number of commercial banks operated in United States. A total of 30,812 banks and trust companies were operating in 1921, as well as a large number of mutual savings banks, savings and loan associations, and some credit unions. By 1929, the number of commercial banks had fallen to 25,330, mainly through bank closings and mergers. The bulk of these were concentrated among small institutions, especially those in rural districts that were adversely impacted by the post World-War I farm recession. (20)

During the decade of the 1920s, banking practices underwent fundamental changes that reflected historic/structural shifts in the non-financial sectors of the economy. For example, large corporations began employing their own funds or stock issues as working capital. (21) Consequently, the growth of short-term commercial loans, the cornerstone of commercial banking, remained relatively stagnant. Changing corporate financing procedures were reflected in the fact that demand deposits, created through commercial loans, scarcely grew at all during the decade. Bank demand deposits amounted to \$8.7 million in 1921 and by the end of 1929 totalled only \$10.9 billion. To offset the change in corporate cash management practices, banks expanded their holdings of securities and real estate loans. As one bank analyst wrote:

"Member banks of the Federal Reserve System increased their investments by two-thirds between 1920 and 1929, more than doubled their loans on securities in the same period, and expanded their loans on urban real estate about 3 1/2 times. All other loans--mainly commercial--remained stationary in these nine years. (22)

As a result of the decline in corporate borrowing, banks shifted emphasis toward multi-line financial services. Thus, rather than confine their earning assets to conventional commercial loans, banks began marketing a wide array of consumer financial services and instruments such as savings accounts, consumer credit, and loans on securities. Indeed, banks entered the small cash loan market in spite of their traditional aversion to personal, consumer loans. (23)

The impact of the Great Depression halted and reversed nearly all extensions of commercial banks into the new consumer markets. Moreover, the extension of banks into the consumer loan market ceased as consumer spending fell with the contraction. In a global sense, not only did the depression temporarily extinguish virtually every profitable avenue for commercial bank growth but it caused a series of major bank failures.

The first series of bank failures hit the United States during 1929 and the early 1930s. In 1929, 659 banks closed their doors, and in 1930, the number doubled to 1,352. A moment of relative calm set in, but was subsequently broken in the spring of 1931 by a second wave of failures as bank closures rose to 2,294. A final, more drastic run on banks began in January, 1933. In March 1933, when President Roosevelt temporarily closed all banks, the financial structure of the United States had approached near total collapse. Between 1930 and 1933, the financial community experienced heavy losses as 9,096 banks, 526 savings and loans, and 30 mutual savings banks ceased operations. (24)

The collapse of these institutions was expressed in a tremendous reduction of total financial assets. Bank assets plummeted \$23 billion, a drop of almost 31 percent. The assets of savings and loan associations fell \$2 billion, a 21 percent reduction. The decline in the number of mutual savings banks was not reflected in a similar movement of their total assets, which increased \$684 million, or 6.7 percent. This segment of the financial industry was subject to a redistribution of funds and/or a partial absorption of funds released elsewhere in the financial system.

The popular political-economic view during this period traced the financial market collapse, and particularly the demise of the commercial banking system to excessive competition in the provision of banking services and speculative activity and conflicts of interest due to the active participation of commercial banks in investment banking during the 1920s. Consequently, financial markets and institutions were subjected to the most comprehensive set of reforms and regulations ever seen in the history of the U.S. financial system. (25)

It was generally assumed that competitive markets encouraged banks (and other financial institutions) to take on levels of risk unsafe for the financial system and ultimately unsound for the economy. Since it was believed that the collapse of the financial system occurred because market competition forced financial institutions, most notably banks, to adopt unsound practices, the reforms attempted to assure stability by restraining competition. (26) On the one hand, the reforms limited the markets that each type of financial institution could serve. On the other hand, since it was assumed that competition caused interest rates to

increase, the reforms placed ceilings on the amount of interest which could be paid on various types of deposit accounts. This new regulatory regime also included the creation of financial depository insurance, the creation of new governmental supervisory agencies, and the strengthening and centralizing of the role of the Federal Reserve as "watchdog" over credit conditions and the money supply.

Because they dominated the financial system, reform centered on commercial banks. Banking reform of the 1930s included the following elements: (27)

- The separation of commercial and investment banking. The Banking Act of 1933, known as the Glass-Steagall Act, prohibited commercial banks from engaging in most underwriting and other investment banking activities. The intent was to limit a bank's investments to short-term, "self-liquidating" commercial loans and other liquid assets.
- Restrictions on the payment of interest on deposits. Banks were prohibited from paying interest on demand deposits and the Federal Reserve was given the authority (Regulation Q) to set ceiling rates on time deposits and saving deposits. Such regulation limited a bank's ability to use explicit deposit pricing to compete.
- Deposit insurance and regulated market entry. The Banking Act of 1933 also established the Federal Deposit Insurance Corporation to administer a national deposit insurance system. The Act set specific and generally restrictive guidelines for the granting of national bank charters and indirectly set standards for state bank charters through the conditions it imposed for admission into the insurance system. Federal deposit insurance was also established for savings and loans at the same time.
- Maintenance of geographic restrictions on branching. The banking legislation of the 1930s prohibited interstate banking and required nationally chartered banks to conform to restrictions imposed by state law in the states in which they operated.

As will be seen through the following chapter, these conditions established the financial system regulatory structure that prevailed well into the 1970s.

The Rise of Consumerism

During the decade of the 1920s, broad socio-economic and intellectual changes came to a head which necessitated the redefinition of thrift and consumption habits. The long process of economic growth, the immense productive capacity created, and the return of prosperity after 1921 brought to fruition the wealthiest, most productive society seen in history. The 1920s marked the birth of the modern mass-consumption American society, or as Filene would call it "The Machine Age". (28)

Consumer Thrift

Integral to the emergence of the new consumer age was a corresponding change in banking practices as bankers had to overcome deeply ingrained beliefs with respect to the "proper" nature of consumer thrift and spending. (29) As Filene so vividly discussed, the age of the conservative banker had come to an end:

"The conservative banker has learned his banking from another age--an age in which it was absolutely necessary, if there was ever to be a machine civilization, that the people generally should consume much less than they were producing, and that the resulting surplus be employed in the financing of more production....Obviously, if people generally spent their money as fast as they got it--if they used it all up in riotous living instead of putting some part of it in the bank, there would not be any surplus money available for financing of further enterprises. Bankers, then, were eminently sensible when they advocated thrift."

Filene continued:

"The great business need now was to keep the machine going, and it could be kept going only if its products were bought, and the machine was so productive that it was necessary for the masses generally to buy and buy abundantly....They were in the same fix now that would-be producers were in a generation and two generations before. They needed credit. It was, although the bankers did not know it, the greatest credit crisis of the times." (30)

The old-fashioned bankers viewed themselves as trustees of other peoples' money, and regarded thrift (the "painfully" accumulated savings of the working poor) as possessing special sanctity. This Calvinistic conception of thrift was also the foundation of an ideal lending policy--loans should be made only cautiously and for "provident and productive" purposes, never for the purchase of "luxuries or wasteful products." The ideology of thrift assumed that these qualities were essential to the economic progress of a nation. Thrift, it was held, contributed to political stability by educating the masses in sound economics and, through their savings, affording them a stake in society. Borrowing to purchase luxuries was not only immoral but unpatriotic. (31)

In spite of the lingering Protestant concept of thrift, during the 1920s, household funds were being increasingly absorbed by the widespread growth of consumer instalment lending; by the stock market; and by thrift institutions. Viewing the apparent success of consumer finance companies, Morris Plan Banks, sales companies, and credit unions, banks departed from functional specialization and became the "department stores of finance". Thus, many banks opened consumer savings departments which led to an increase in consumer savings deposits as a percentage of total bank deposits.

The new notion of thrift reconciled saving with the newly acquired attitude toward consumer spending habits and more sophisticated decision-making with respect to household investment. Bankers soon came to recommend planned control of family income and expenditures. The thrifty man no longer simply hoarded his income. He allocated it over the purchase of various consumer goods, investments, and to savings. However, the further development of these new notions of a consumer mass-consumption society and the new attitude toward thrift were stifled by the combined influence of the Great Depression and World War II. The practical notion of household financial management of funds did not reappear until the 1970s.

The confluence of the above factors led bankers to redefine their position vis-a-vis consumer credit. In doing so, bankers developed certain standards to ensure that consumer credit would not be abused by individuals and thereby endanger the economy. Such protection/insulation was achieved through the development of "scientific formulas" which called for investigation of the loan applicant, regulation of the size of the downpayment, and determination of the length of the amortization period. Once bankers had developed adequate standards for consumer (installment) credit, they began making loans directly to consumers. They also attempted to impose standards on the finance companies which acted as middlemen in the channeling of bank funds to consumers. (32)

In certain respects, the credit unions of 1921-1945 ascribed to the old-fashioned notion of thrift and confined member borrowing largely to remedial loans. As stated in the Federal Credit Union Act of 1934, federal credit unions were established to promote thrift and to provide credit for

"provident and productive purposes". The idea of promoting the financial welfare of the "little man" was expressed in the original trademark of the industry, which was a small man holding an umbrella marked "credit union", over which were written "hardtimes", "sickness" and "financial distress". The ideology of the early leaders stressed that credit unions, as cooperative institutions of thrift, help promote personal responsibility and financial stability through the promotion of thrift. (33)

Consumer Credit

Until 1920, households generally employed credit during periods of depressed economic conditions. Consequently, consumer credit generally moved countercyclically. Thus, when business activity shrank, loan volume inflated. After 1920, consumer credit served households increasingly as a method to increase purchasing power when the economy was on an upswing. By 1929, movements of consumer credit began to corresponded roughly with changes in national income. Cyclical movements of both series coincided closely over time, although the extent of the fluctuation varied. The evidence available suggests, that during the depression of 1920-1921, consumer credit declined only slightly in spite of a substantial decline in national income. However, during the early years of the depression, 1930-1933, the rate of contraction of consumer credit was as great as the rate of decline of national income. (34)

Of course, this transformation took place neither entirely nor solely during the 1920s. As discussed in Chapter Three, consumer borrowing habits had been changing since the end of the Civil War with that long process of

development coming to fruition during the 1920s. Further development, however, was impeded by the Great Depression and by World War II.

The expansion of the consumer goods markets during the 1920s was reflected in the growth of consumer credit. The outstanding amount of consumer credit more than doubled between the beginning of 1923 and the fall of 1929, as the long period of development was culminated by a few years of enormous expansion. Consumer credit increased from \$2.9 billion in 1920 to \$7.1 billion by 1929, an increase of 140 percent. During this period, consumer installment credit grew in relative importance as non-installment forms of credit declined. As a percentage of total consumer credit outstanding, installment lending grew from 30.3 percent in 1919 to nearly 50 percent by 1929. The growth of installment credit, as compared to open-book credit, was led by increased consumer expenditures for consumer durable goods, most notably the radio, the mechanical refrigerator, the automatic furnace, and the automobile, all of which appeared during the 1920s. (35)

The expansion of consumer credit ended soon after the stock-market collapse in September, 1929. By 1933, consumer installment credit stood only slightly above its 1923 level. Consumer credit then began expanding thereafter surpassing its 1929 peak by 1936. For consumer credit as a whole, the expansion continued until 1938 as it increased 8.6 percent in 1933, 23 percent in 1935, 22.8 percent in 1936, and 9 percent in 1937. As a percent of total consumer credit outstanding, the share of installment credit increased to 59.3 percent by 1937. The expansion of consumer credit during this period was dominated by automobile financing. As a share of

total consumer installment credit, automobile loans grew to 21.5 percent by 1937, whereas in 1932 automobile loans were only 8.8 percent of total consumer installment credit. (36)

Consumer credit expansion dampened in 1938. This downturn, however was less severe than in 1929, as it lasted only one year. Consumer credit began expanding again by 1939 and continued until the start of World War II. The consequent imposition of war rationing, in the form of Regulation W, drastically curtailed consumer spending.

The start of World War II made it necessary to significantly cut back on the production of consumer goods, particularly consumer durables. Acting under the authority of the president, the Federal Reserve Board issued to all financial institutions conditions under which credit could be extended. The regulations applied to credit extended for the financing and refinancing of consumer durable goods by setting up minimum down payments and a maximum permissible maturity date for the installment contract. As a result, total consumer credit outstanding fell 34.8 percent in 1942 and 18.1 percent in 1943. Installment credit fell even more dramatically as it declined 48 percent in 1942 and 32.5 percent in 1943. As it will be shown below, credit union loans outstanding were severely impacted by the effects of Regulation W. (37)

Massachusetts Credit Unions

To assess the impact of the Great Depression on credit union growth and development, the following analysis will focus on the effects of the economic contraction on credit unions in Massachusetts. Since the evolution of credit union progress has been statistically documented there, Massachusetts provides an excellent basis from which to view the reaction of credit unions to the contraction. (38)

The economic disarray caused by the Great Depression interrupted the development of credit unions in Massachusetts. Whereas these credit unions had been on the increase since 1909, the number in operation declined from 309 in 1930 to 282 by 1933. Total membership declined 7.2 percent during the same period. From 1929 to 1933, total assets declined 26 percent. The reduction in assets was motivated by a sharp decline in member savings, as the latter fell 29 percent during the same period.

Credit union growth resumed in 1934, as the number of credit unions, total membership, and total assets all rose from their low points of 1933. The advance continued during the following years, as record benchmark levels were reached by 1937. At the end of that year, there were 419 credit unions with a total membership of more than 168,000 and total assets of over \$19 million.

Except for the recession of 1921, credit union loans outstanding rose in every year from the emergence of credit unions (in Massachusetts) to the stock market crash in 1929. During the early years of the depression,

loans outstanding fell nearly 30 percent, from a peak level in 1929 of \$12.7 million to a depression low in 1933 of \$8.9 million, a decline of nearly 43 percent.

The number of credit unions and the total assets of each of the several types is given in Table 4.6. This table details the comparative trends of development and the comparative reactions of the different types of credit unions to the depression of the 1930s.

Table 4.6

Number and Total Assets of Massachusetts Credit Unions, By Type of Membership
(assets in thousands of dollars)

Type of Membership	1926		1929		1933		1937	
	Credit Unions	Total Assets	Credit Unions	Total Assets	Credit Unions	Total Assets	Credit Unions	Total Assets
Occupational	36	\$2,279	66	\$3,916	97	\$5,120	235	\$10,924
Industrial	13	\$337	24	\$653	45	\$717	124	\$2,929
Government	7	\$329	17	\$965	23	\$1,375	49	\$2,399
Utilities	8	\$1,145	10	\$1,445	12	\$1,892	16	\$3,399
Schools	1	\$7	3	\$16	3	\$37	18	\$190
Stores	3	\$280	3	\$354	5	\$381	9	\$595
Trans	2	\$175	5	\$440	5	\$664	10	\$1,321
Other	2	\$6	4	\$43	4	\$54	9	\$91
Community	122	\$4,866	153	\$6,947	111	\$3,806	103	\$4,610
Ethnic	34	\$3,553	54	\$4,821	47	\$3,806	48	\$3,252
Associational	13	\$308	23	\$478	27	\$298	33	\$450

Source: Joseph Snyder, Credit Unions In Massachusetts, p. 55.

The most noteworthy fact revealed is the great contrast between the occupational and the community based credit unions. Whereas the occupational unions grew rapidly, even from 1929 to 1933, the community credit unions dwindled. In 1926, there were 122 community unions and only 36 occupational unions. Both types had grown more numerous by 1929, but from 1929 to 1933, the number of community credit unions decreased whereas the number of occupational credit unions increased. From 1933 to 1937, the number of community unions continued to decline in number, falling to 103 in 1937, while the occupational unions increased sharply to 235. Total assets of the community unions were a third less in 1937 than in 1929, whereas assets of the occupational unions grew nearly 400 percent during the same period. In total assets, although not in number of unions, ethnic based credit unions displayed an upward trend, which was interrupted by the depression.

Performance of credit unions in industrial establishments was the most striking. In 1926, there were only thirteen industrial-based credit unions with total assets of \$337 thousand. By 1929, both the number of credit unions and total assets had nearly doubled; and by 1933, despite the depression years, the number and level of assets had nearly doubled again. Between 1933 and 1937, the number of credit unions increased from 45 to 124 while total assets grew 300 percent, from \$700 thousand to \$2.9 million.

Credit unions among governmental employees displayed a growth in assets comparable to that of the industrial unions, although in number they did not grow as rapidly. In 1926, there were seven of these unions, with

assets of \$329 thousand; by 1937, there were 49, with assets of \$2.4 million.

The aforementioned differences in growth and developmental trends clearly suggest that, by the 1930s, the occupational based credit union had become the superior form with respect to common bond type.

Federal Credit Unions

Faced with an economic breakdown of unprecedented proportions, the federal government accepted the responsibility of direct public relief programs. An extensive range of structural reforms were instituted in the American economy. These reforms affected banking, the stock exchange, labor organization, agriculture, and many other spheres of economic activity. The "New Deal" altered the fundamental relationship of the federal government to the economy. An integral element of the "New Deal" was the establishment of minimum rates of wages in various industries. The occurrence of this event provides striking evidence that, during the depression, financial security was still a tenuous and somewhat illusive hope for millions of American wage earners. Consequently, in conjunction with "New Deal" legislation, a federal law, the Federal Credit Union Act, was passed permitting the incorporation of credit unions as a cooperative form of financial security for wage earners. The aim of the Federal Credit Union Act was to provide a solution to the thrift and borrowing needs of wage-earners, (i.e., individuals of small incomes). (39)

The Federal Credit Union Act

The Federal Credit Union Act, approved June 26, 1934, authorized the organization of Federal Credit Unions (FCUs) under charters issued by the Governor of the Farm Credit Administration, who was also responsible for approving credit union by-laws and prescribing regulations for credit union operations. According to the Act, membership in a credit union was limited to persons having a common bond of occupation, association, or to persons within a well-defined neighborhood or rural district. Each member had to subscribe to at least one \$5 share, payable either in cash or in installments and all members were required to pay an entrance fee of 25 cents.

The management of a federal credit union was entrusted to a board of directors of not less than five members; a credit committee of not less than three members; and supervisory committee of three members, not more than one of whom could be a board member. All board members were chosen by and from the membership at large, with each member having one vote regardless of the number of shares owned. Voting by proxy was not permitted.

The original Act required that member loans be made for a period not to exceed two years, and had to be for "provident" or "productive" purposes. An unsecured loan could not exceed \$50 in amount and no loan could exceed \$200 or 10 percent of the unimpaired capital and surplus of the credit union whichever was greatest. Moreover, the original Act restricted investments of surplus funds to U.S. Government obligations and/or to

securities fully guaranteed as to principal and interest by the Federal Government.

Interest on loans could not exceed 1 percent per month on the unpaid balance, inclusive of all charges incident to making the loan. Within this limit, each credit union determined its own interest rate. No additional charges for any purpose could be made, with the exception of entrance fees and small fines as authorized in the credit union's by-laws. All entrance fees and fines plus 20 percent of the net earnings of each year, had to be set aside in a reserve fund against losses before dividends could be paid. At the annual meeting of members and upon the recommendation of the board of directors dividends could be declared from the balance of net earnings. Dividends, however, were not to exceed 6 percent. (40)

Federal Credit Union Progress: 1934-1939

The first federal credit union (FCU) was chartered October 1, 1934 and during the next five years federal credit union growth exploded. By 1936, 1,662 FCUs had been chartered and membership of the 1,279 FCUs submitting reports in that year amounted to 243,499 members. By 1939, 3,544 FCUs had been chartered and membership in the 3,127 FCUs reporting reached 837,362. Growth in total membership was not simply the result of the organization of new credit unions, as is evidenced by the fact that the average membership per credit union grew from 180 in 1936 to 268 by 1939.

The simplicity of the early federal credit unions is manifest in their balance sheets. On the asset side, the balance sheet consisted of loans,

cash and "other" assets. The other asset category consisted primarily of investments in U.S. Government obligations. Member shares, notes payable, reserves for bad loans, undivided profits (i.e., earnings), accounts payable and other items comprised the liability side of the balance sheet.

Total assets-liabilities increased 501.5 percent between 1936 and 1939, from \$7.6 million in 1936 to \$46.9 million by 1939, an increase of nearly 746 percent. Because assets-liabilities of FCUs grew more rapidly than did the number of newly chartered FCUs, assets-liabilities per FCU rose from \$5,417 in 1936 to \$15,002 by 1939.

Member loans dominated the asset side of the balance sheet, accounting for 80.3 percent of total assets in 1936 and 78.8 percent of total assets in 1939. From 1936 to 1939, the average dollar amount of loans rose steadily as did the total number of loans. Beginning in 1937, the latter appears to have grown more rapidly than the average dollar amount of loans. The average amount of loans outstanding per FCU rose from \$4,543 in 1936 to \$11,827 by 1939. This is an increase of 160 percent. Average loans outstanding per member rose from \$24 in 1936 to \$44 in 1939. In 1936, FCUs as a whole extended 60,141 loans as opposed to 1.85 million loans in 1939. By the end of the 1930s, FCUs were extending more loans at a greater dollar amount.

In 1936, 18 percent of FCU assets consisted of cash and by 1939 cash accounted for 14 percent of total assets. The residual, "other" assets consisted of U.S. Government Bonds and shares and accounts in federal savings and loan associations. Whereas, in 1936, other assets were zero,

by 1939, nearly 7 percent of total FCU assets were in U.S. Government obligations.

Member shares constituted the largest single liability category. Member shares fell from 92.8 percent of liabilities in 1936 to 78.8 percent of liabilities in 1939. Over the same period, accounts and notes payable accounted for less than 2 percent of total liabilities. Reserves fluctuated between 2 and 2.6 percent of total liabilities between 1936 and 1939. Over the same period, undivided earnings, as a percent of total liabilities, ranged from 2.8 percent to 4.4 percent, and then fell back to 2.8 percent in 1939. Capital, i.e., the sum of reserves and undivided earnings, amounted to 4.7 percent in 1936 and 4.4 percent in 1939.

The bulk of FCU income was derived from interest income on loans. In 1939, over 97 percent of income of all FCUs consisted of income from loans. In spite of generally stagnant economic conditions during the late 1930s, loan interest income increased 824 percent, while total income rose 725 percent. Total expenses increased 906 percent over the same period. FCUs consequently earned a healthy, though falling, level of net income. In 1939, net income was roughly 233.9 percent of total expenses. However, by 1938-1939, expenses rose relative to gross income thereby leading to a decline of the net profit rate to 166.9 percent in 1939.

Return on assets, a measure of income earning efficiency of a given array of assets, rose from 5 percent in 1936 to 7.2 percent by 1939. The expense to asset ratio, a measure of overall cost efficiency of credit union operations, rose from 1.5 percent to 2.7 percent by 1939. Since

these early FCUs were non-profit, member oriented institutions, the return on assets was not a significant operational consideration, and thus remained relatively low. In addition, the expense to asset ratio was generally low because of the fact most of these early FCUs operated on the basis of a subsidy, as their operations were generally conducted on the premises where members were employed.

Federal Credit Union Progress: 1940-1945

In 1942, for the first time, FCU progress displayed a downward trend. This situation was not peculiar to credit unions but was shared by all other types of financial lending institutions, though not all showed as sharp of a decline as did credit unions. There were numerous reasons for the decline, among which may be cited the limitations on installment buying and the consequent sharp contraction of the activities and purposes for which credit union loans were made. Loans for such things as house repairs, the purchases of furniture, refrigerators, automobiles, etc. were drastically reduced not only because of shortages of civilian goods but by the imposition of Regulation W. The latter limited the size of personal loans and the corresponding maturities. Nevertheless, members continued to borrow from their credit unions, although the loans were of smaller amounts and were contracted for a much narrower range of purposes--largely for family emergencies, such as expenses associated with illness or death, and/or for consolidation of debts, etc.

That World War II seriously hampered FCU development which can be most vividly demonstrated in terms of the progress in the number of federal

credit unions, membership, and loans outstanding. As a large portion of the labor force joined the armed forces and the remaining labor force worked increasingly more overtime, the lack of time to engage in credit union activities impacted the establishment of new FCUs as organizational efforts waned. Consequently, the number of new charters declined and/or liquidations rose. However, on a positive note, as member earnings were rising, FCUs experienced considerable growth in shares as members used their credit unions as a depository for their savings moreso than as a source of consumer credit. (41)

During the course of the war, membership in FCUs displayed a downward trend, falling over 9 percent between 1942 and 1945. The number of new charters issued fell from a high of 777 in 1940 to a low of 69 in 1944. The number of charters cancelled also increased, from 76 in 1940 to a high of 245 in 1944. From 1942 until 1945, the number of FCUs declined over 7 percent and the number of members per FCU fell from 337 in 1941 to 324 by 1945.

Loans outstanding also declined in both absolute dollar terms and as a percentage of total assets. In dollar terms, loans outstanding fell from \$69.3 million in 1941 to a low of \$34.4 million in 1944. Whereas the loan/asset ratio stood at 81.8 percent in 1936, by 1941 it had fallen to 65.5 percent. By 1944, loans outstanding comprised a mere 23.8 percent of total assets. As a result of the dismal loan situation, the ratio of loans outstanding to member shares fell from 71.5 percent in 1941 to 25.8 percent in 1944. The Annual Federal Credit Union Report of 1942 explains the decline as follows:

"The decline was the result of several factors. The making of certain types of loans formerly desired by members was restricted by Regulation W of the Board of Governors of the Federal Reserve System relating to consumer credit. Because of the diversion of the productive capacity of the nation from durable consumer goods to war material, many articles for the purchase of which credit unions members might have borrowed were not on the market. Vacations and consequently vacation loans were eliminated or curtailed by the pressures of work, by transportation difficulties, and by gas rationing. Higher weekly family incomes resulting from higher wage rates, from longer working hours, and from the employment of individuals formerly not gainfully employed reduced the need of members to borrow." (42)

Federal credit union assets-liabilities increased at a much slower rate than during the early years--28.4 percent between 1942 and 1945. The composition of FCU liabilities remained virtually unchanged, as member shares funded nearly 92 percent of total assets throughout the war. Because of the restrictions on consumer credit and the consequent reduction in the demand for consumer loans, FCUs were compelled to adjust the mix of their income-earning assets. As experienced by other financial depositories during the war, FCUs increased their holdings of U.S. Government securities. Thus, FCU holdings of U.S. Government bonds rose from \$1.1 million in 1940 to \$77 million by 1945, a mix that represented 50.3 percent of total assets in 1945. FCUs also increased, though not as dramatically, their investments in federal savings and loan association shares. These investments increased from 7 percent (\$4.9 million) of total assets in 1940 to 13.7 percent (\$19.7 million) in 1944. The proportion of their portfolios held as cash stabilized at approximately 14 percent. Regular reserves continued their upward trend during the war, as they rose to 3.1 percent of total assets by 1945. Undivided earnings stabilized at 2.5 percent of total assets by 1945. As a result, capital stood at only 5.6 percent of total assets in 1945.

As interest on member loans provided over 80 percent of FCU income prior to the second world war, a dramatic decline in member loans during the war caused a severe reduction in total income. Loan income fell by \$2.2 million between 1942 and 1945, from \$5.6 million (89.9 percent of total income) to \$3.4 million (61.2 percent of total income). While income earned on investments increased, the increase failed to sufficiently offset the reduction in income earned on member loans. In 1942, investment income amounted to \$247,642 but rose to \$1.9 million by 1945, and increase of \$1.6 million. In short, total income fell to \$5.6 million in 1945 from \$6.3 million in 1942. Total expenses, in contrast, decreased slightly, from \$3.2 million in 1942 to \$3.1 in 1945. Net income therefore fell between 1942 and 1945, from approximately \$3.1 million in 1942 to \$2.6. Reflecting these relative movements in income and costs, net income fell from 98 percent of total expenses in 1942 to 84.1 percent of total expenses in 1945.

Return on assets fell to 3.7 percent by 1945, indicating the reduced income earning capacity of investments in contrast to member loans. The expense to asset ratio fell to 2.1 percent, indicating the reduced operational costs associated with the reduction of activity that resulted from the war. The fact that the return on assets fell more than the expense/asset ratio explains the decline in the rate of profit discussed previously.

Evolution of Federal Credit Union Types

As early as 1936, an overwhelming concentration of membership, assets, shares and loans was evidenced in occupational FCUs. This group's relative share of membership and of total number of FCUs declined slightly during the late 1930s, albeit occupational FCUs continued to dominate in number and membership. In terms of assets, shares, and loans, occupational FCUs realized a slight increase in their share of total FCU holdings. The following provides a descriptive narrative of growth trends by FCU type over the years under review.

Associational Federal Credit Unions

In 1936, associational FCUs comprised 7.7 percent of all FCUs, and accounted for 3.5 percent of total FCU membership. By 1945, the proportion of associational FCUs reached 12.9 percent and the membership in associational FCUs reached 8.3 percent. In terms of members per union, associational FCUs increased from 88 members per establishment in 1936 to a total of 210 members per establishment in 1945. From 1936 to 1945, the average membership per associational based FCUs increased 138.6 percent.

Associational FCUs in 1936 handled 5.6 percent of total FCU assets-liabilities and by 1945 the figure reached 6.9 percent. This represents a 427.4 percent increase from 1936 to 1939; 143.6 percent increase from 1939 to 1942; and a 93 percent increase from 1942 to 1945. Over the entire period, the rate of asset-liability growth was a phenomenal 2,378 percent. Since the rate of asset-liability growth was greater than

the rate of growth in the number of associational FCUs, assets per associational FCU increased. From 1936 to 1945, average assets per associational credit union grew from \$4,272 to \$22,012, a growth of 415 percent.

Underlying and driving the growth in assets-liabilities was member savings growth. Member savings per associational FCU grew from \$4,087 in 1936 to \$20,697 in 1945, a growth of 406 percent. The savings/asset ratio remained relatively stable throughout this period, ranging from 95.7 percent in 1936 to 92.5 percent in 1945, which indicates that the bulk of asset-liability growth resulted directly from member savings growth. Outside sources of funds were relatively insignificant.

Average savings per member continually expanded during this period, as member savings increased from \$46 in 1936 to \$99 in 1945. The combined growth in members per credit union and in savings per member provided the cornerstone underlying the increase in average assets per associational FCU.

Regular reserves stood at 1.6 percent of total assets in 1936, and reached 3.4 percent in 1942. By 1945, the regular reserve/asset ratio had fallen to 2.7 percent. Undivided earnings also stood at 1.6 percent in 1939 and climbed to 4.2 percent by 1941. By 1942, undivided earnings began to decline, falling to 3.9 percent in that year and dropping to 2.4 percent by 1945. The trends in these two ratios prompted the capital/asset ratio to rise to 7.3 percent by 1942 and then fall to 5 percent in 1945.

With respect to loans outstanding, by year-end 1936, associational FCUs averaged a total of \$2,570 in loans outstanding. By 1945, this figure reached \$7,392, a growth of 187.6 percent over the entire period. Of course, growth during these years was severely interrupted by the impact of Regulation W. Consequently, upon increasing from 60.2 percent to 77.9 percent from 1936 to 1939, the loan/asset ratio fell to 33.6 percent by 1945. Loans per member were \$29 in 1936 and only \$35 in 1945, thus exhibiting the effects of Regulation W.

To offset the reduction in loans outstanding, associational FCUs shifted earning assets to external investment instruments. Investments in U.S. Government bonds increased from 9.7 percent of total assets in 1939 to 50.3 percent by 1945. In addition, investments in federally insured saving and loan associations increased, as these reached 7.9 percent of total assets by 1945. Loans to other credit unions remained insignificant throughout the period from 1936 to 1945.

As assets shifted out of member loans and into investment instruments, a reduction in income earned through loans and an increase income earned through investments resulted. Whereas loan income as a proportion of total income reached 96.2 percent in 1939, this source of income fell to 76.4 percent by 1945. In contrast, investment income increased from zero in 1936 to 2.1 percent by 1939 and reached 21.1 percent of total yearly income by 1945. Income from other sources, such as service fees and entrance fees ranged from a high of 13.3 percent in 1936 to 2.2 percent by 1945. The resultant shifts in the relative importance of the various types of income flows caused the net profit rate to fall from a high of 202 percent in 1937

to a low of 80.6 percent in 1944 and 99.6 percent by 1945. As alluded to previously, the reduction in the net profit stems from the decline in the income/asset ratio (i.e., return on assets), from 7.1 percent in 1941 to 3.7 percent in 1945, compared to a somewhat stable expense/asset ratio of 2.9 percent in 1941 and 1.9 percent in 1945.

Residential Federal Credit Unions

Residential FCUs were only a small portion of total FCUs in 1936, as they comprised only 3.1 percent of the total number of FCUs and only 1 percent of total FCU members. By 1945, the proportion of FCUs which were residential based declined to 2.9 percent, while the number of members rose slightly to 1.1 percent. In 1936, the typical residential FCU had only 70 members; by 1945, the average members per residential FCU stood at 182, reflecting a 160 percent growth.

Total assets-liabilities increased from \$92 thousand in 1936 to \$1.2 million by 1945, an increase of 1,165 percent. Similar to the associational FCUs, the typical residential FCU displayed substantial growth. In 1936, the average level of asset-liabilities of a typical residential FCU stood at \$2,653, whereas by 1945, the average asset-liability level reached \$16,099, a growth of 507 percent. In spite of substantial growth, residential credit unions remained relatively insignificant in terms of total FCU assets-liabilities. Residential FCUs handled a mere 1.2 percent of total FCU assets-liabilities in 1936. By 1945, residential FCUs handled only .8 percent of total FCU assets-liabilities.

The level of savings as a percentage of total residential FCU assets-liabilities were consistently in the neighborhood of 91 to 95 percent over the period being reviewed. From a low of \$36 per member in 1936, savings per member increased to \$94 by 1945, a 161 percent increase in per member savings. Savings per residential FCU increased from \$2,526 in 1936 to \$15,245 in 1945, a 504 percent growth.

After reaching a high of 3.1 percent in 1942, the reserve/asset ratio fell to 2.7 percent by 1945. In addition, undivided earnings fell from a high of 3 percent in 1942 to 1.9 percent by 1945. The result of these movements was a decline in the capital/asset ratio from 5.9 percent in 1939 to 4.6 percent in 1945.

Member loans accounted for 52.7 percent of total assets in 1936, and by 1945, the loan/asset ratio stood at only 26 percent, thereby providing another example of the impact of Regulation W on member borrowing. On average, loans outstanding were \$1,399 per union in 1936 and \$4,186 by 1945. In contrast, in 1944, loans per member fell to below its 1936 level. In 1944, loans per member equaled \$19 and rose to \$23 by 1945. In 1936, loans per member equaled \$20. In 1936, the loan/asset ratio was 52.7 percent; by 1938, this figure stood at 75 percent. Thereafter, however, loans as a percentage of total assets declined and bottomed out at 20.9 percent by 1944. The ratio increased to 26 percent by 1945.

To offset the decline in loans outstanding, residential FCUs increasingly invested funds in U.S. Government bonds. In 1936, residential FCUs had no funds invested outside of member loans; by 1945, 42 percent of

total assets were in government obligations. In addition, some 8.2 percent of investments funds were placed in savings and loan shares by 1945.

As with the associational based FCUs, the shift in assets caused the distribution of income to shift as well. Whereas loan income dominated the total income flow over the early years, more than 25 percent of total income was derived from investment income in 1945. Service charges and other fees never amounted to more than 7.4 percent of total income in 1937; by 1945, this source of income fell to 2.2 percent. The income/asset ratio fell to 2.9 percent in 1945 as compared to 6.9 percent level in 1939. The expense/asset ratio also fell, from 3.3 percent in 1939 to 1.4 percent in 1945. The combined effects of the interaction between these two ratios prompted a reduction in the net profit rate from 108 percent in 1939 to 61.6 percent in 1944. The net profit rate increased to 109 percent by 1945.

Occupational Federal Credit Unions

By 1936, occupational FCUs comprised 89.3 percent of all FCUs and had 95.6 percent of all FCU members. The advantage of having members employed by a single employer supported vigorous growth and widespread development of occupational based FCUs. In 1936, there were 1,662 occupational FCUs which were distributed as follows: 44.7 percent served the manufacturing sector; 12.9 percent served the combined transportation, communications, and public utilities sector; 7.8 percent served the wholesale and retail industry; 1.7 percent served employees in the finance and insurance sector; 10.7 percent were in the service industry; 19.9 percent served governmental

employees; and 2.3 percent of all occupational based FCUs served miscellaneous employee groups.

By 1945, the number of occupational FCUs rose to 4,345, an increase of 161 percent. In spite of this growth the proportion of FCUs serving occupational groupings declined to 84.3 percent. The distribution within the occupational grouping shifted slightly as manufacturing and the combined transportation, communication, public utilities sector of FCUs both increased their percentage shares, the former rising to 46.8 percent while the latter rose to 14.5 percent. Governmental based FCUs declined to a 16.7 percent share of the total number of FCUs. As the proportion of FCUs served by occupational groups declined so to did the proportion of members served by these groups. The membership share of the occupational FCUs fell to 90.6 percent by 1945.

On average, occupational based FCUs had more members than either associational or residential FCUs. The typical occupational FCU in 1936 had 190 members, with the smallest number in services, 109 members per credit union. At the other extreme, wholesale and retail based FCUs served 253 members per establishment. By 1945, the occupational FCUs had grown to 344 members per establishment, with service sector FCUs serving only 197 members per establishment and FCUs in the transportation, communications, and public utilities sector serving 405 members per establishment.

Assets-liabilities at occupational FCUs increased from \$7.1 million in 1936 to \$141.3 million by 1945, an increase of 1,879 percent. In terms of the distribution of total FCU assets-liabilities, the percentage held by

occupational based FCUs declined slightly, from 93.2 percent in 1936 to 92.3 percent in 1945. In general, whereas occupational FCUs experienced only a slight decline in assets-liabilities relative to all FCUs, significant shifts occurred within the occupational grouping. For example, from 45.6 percent of occupational based FCU assets-liabilities in 1936, manufacturing based FCUs increased their share to nearly 53 percent by 1945. Transportation, communications, and public utilities sector based FCUs were also big gainers as their share rose from 11.8 percent in 1936 to 18.4 percent by 1945. The governmental FCUs and wholesale/retail based FCUs experienced reductions, as the share of the former fell from 23.8 to 15.5 percent and the share of the latter fell from 9 to 4.5 percent.

As with the other types of FCUs, the growth in assets-liabilities stemmed directly from the growth in member savings. Member savings per occupational FCU increased from \$5,167 in 1936 to \$40,445 in 1945, an increase of 682.8 percent. This upward trend in savings per credit union was driven by a growing level of savings per member. From a low of \$27 in 1936, savings per member reached \$118 by 1945. The growth in savings per member was a function of basically two factors: on the one hand, the potential for increased member savings grew directly out of the higher earnings consequent of war-time production and, on the other hand, the rationing of consumer goods left members with large amounts of excess disposable income.

The trends in regular reserves and undivided earnings followed a similar path as was evidenced in both the associational and residential FCUs. Regular reserves increased to 3.1 percent of total assets by 1945

from 1.6 percent in 1939. Undivided earnings was only 2.5 percent in 1945 after having reached 4.4 percent in 1942. In combination, these trends resulted in a slight reduction in the capital/asset ratio, as the latter fell to 5.6 percent in 1945 after reaching 7.2 percent in 1941.

Loans outstanding followed the same general pattern as exhibited by the associational and residential FCUs. In 1936, loans outstanding per occupational FCU stood at \$4,572 and by 1945 reached only \$9,770, an increase of only 113.7 percent. The decline in loans outstanding was reflective of a reduction in loans per member, as the latter increased from a low of \$24 per member in 1936 to a high of \$50 per member in 1939, and then fell to a war-time low of \$26 in 1944. Loans outstanding then increased to \$28 per member in 1945.

As loans outstanding fell the structure of assets shifted. The loan/asset ratio fell from 81.9 percent in 1936 to a low of 22.1 percent in 1945. Offsetting this reduction was an increase in the investment/asset ratio, as investments in government bonds increased to 51.2 percent by 1945. Investments in saving and loans also increased, reaching 12.1 percent of total occupational FCU assets-liabilities.

As the structure of income earning assets shifted so to did the distribution of the flow of income. Whereas in 1936, loan income comprised 86.7 percent of total income, by 1945 this source fell to 60 percent. This reduction is even more dramatic in lieu of the fact that, in 1939, loan income reached 97.6 percent of total income. Investment income rose as high as 33.9 percent by 1945. Service fee and other income reached 6.1 percent

in 1945. With respect to the net profit rate, in 1936 occupational credit unions earned a 243.8 percent net rate of profit, and by 1944 this had fallen to 71.6 percent. However, in 1945, the net rate of profit began to rise, as it reached 82.9 percent and continued upward thereafter.

Return on assets fell to 3.7 percent by 1945 after having reached 7.2 percent in 1939. The expense/asset ratio fell to 2.1 percent from a high of 2.8 percent in 1942. Since most occupational based credit unions were subsidized by the members' employer, total expenses remained fairly stable. Consequently, the fall in the net profit rate was a function of income reduction rather than an increase in costs.

Conclusion

The general conditions that prevailed during the war economy provided the basis for a postwar economic expansion. The income of credit union members, who were predominantly wage and salary earners, rose dramatically during the war. Wartime restrictions forced households to postpone the purchase of many consumer durables. Such restrictions forced savings to be channelled into U.S. Government securities. The rapid growth in shares and sluggish credit union loan growth reflected these wartime conditions. The same wartime rationing of goods and credit subsequently prompted businesses to postpone their investment purchases. As wartime restrictions were lifted and previously suppressed consumer demands were communicated through the market mechanism, businesses responded by increasing output and by enlarging their productive capacity (i.e., investment). In the financial sector, financial institutions held vast quantities of U.S.

government bonds. When the war drew to an end, households, firms, and financial institutions began to channel their liquid assets into the economy and as a result consumer and investment demand grew and, with them, the demand for consumer credit. This ensuing period of prosperity, based in part on this pent-up aggregate demand, would last for over a decade.

Footnotes

(1) For a similar analysis of the emergence of a domestic mass market in conjunction with the spread of industrial production and the rise of the working class in Britain see E. J. Hobsbawm, The Age of Capital, and The Age of Revolution, (London, 1977). While Hobsbawm outlines the process as it occurred in Britain, the general framework he employs also applies to this study.

(2) Randall C. Merris and John Wood, "A Deregulated Rerun: Banking in the Eighties," Economic Perspectives, Federal Reserve Bank of Chicago, Sept/Oct 1985.

(3) It is the contention here that credit unions were afforded a type of infant industry protection, without which they would not have been able to weather competitive financial market forces. Moreover, the effects of the Great Depression and World War II provided credit unions with a market void that they could fill and grow within.

(4) Historical Statistics, Part II, Series U2, p. 864.

(5) Charles H. Hession and Hyman Sardy, Ascent To Affluence: A History Of American Economic Development, (Allyn and Bacon, 1969).

(6) Historical Statistics, Part II, Series S 120, p. 828, Series S 176, p. 831.

(7) Maurice Dobb Studies In The Development Of Capitalism, (International Publishers, 1963) p. 331. Dobb attributes the more rapid growth in the production of consumer durable to the expansion in consumer installment credit.

(8) W.W. Rostow, THE PERILS OF PROSPERITY, 1919-32, (University of Chicago, 1958), p. 43.

(9) Historical Statistics: 1789-1945, Series J 50, J 58, J 65, J 83, J 84, pp. 181-182.

(10) Historical Statistics, Part 1, series A 7, p. 8.

(11) John O'Sullivan and Edward F. Keuchal, American Economic History: From Abundance To Constraint, (Franklin Watts, 1981)

(12) Ibid., pp. 165-66. Attracted by high returns in the stock market, toward the end of the decade many corporations had diverted financial resources to stock market speculation rather than investing in real capital formation.

(13) J.K. Galbraith, The Great Crash, 1929, 2nd edition, (Houghton Mifflin, Co., 1961).

(14) Hession & Sardy, Ascent to Affluence: A History of American Economic Development, (Allyn and Bacon, 1969) p. 630.

- (15) Historical Statistics, Series R 1 p. 783, R 56 p. 789, R 93 p. 796.
- (16) Ibid., Series R 65, p. 768.
- (17) Ibid., Series N 71, p. 623.
- (18) The data refers to wages and salaries paid to full-time equivalent employees. Full-time equivalent employment measures man-hour years per full-time worker and its equivalent performed by part-time workers. Consequently, changes in full-time earnings reflect changes in salaries and wages rather than fluctuations in hours worked.
- (19) Historical Statistics, Part 1, Series F 165, p. 235.
- (20) Randall C. Merris and John Wood, "A deregulated rerun: Banking in the Eighties," Economic Perspectives, Federal Reserve Bank of Chicago, Sept/Oct 1985.
- (21) Ibid.
- (22) G. Soule, Prosperity Decade: From War to Depression, 1917-1929, (Rinehart and Co., 1947) pp. 155-56. Quoted in Hession and Sardy, p. 623.
- (23) Ibid.
- (24) Milton Freidman and Anna J. Schwartz, The Great Contraction, 1929-1933 (Princeton University Press, 1965). See also Raymond W. Goldsmith, Financial Institutions, (Random House, 1968).
- (25) George J. Benston, "Federal Regulation of Banking: Analysis and Policy Recommendations," Journal Of Bank Research, Winter 1983.
- (26) Ibid.
- (27) Alfred Broadus, "Financial Innovation In The United States--Background, Current Status and Prospects," Economic Review, Jan/Feb 1985.
- (28) In Rostovian terms, the U.S. economy had reached the stage in which it faced the challenge of maintaining aggregate demand to match the extraordinary output of goods and services it was capable of producing. See also Alfred L. Roe "Bankers and Thrift in the Age of Affluence," American Quarterly, Winter 1965.
- (29) As mass production increasingly became the norm of industrial production, a corresponding means of financing mass consumption had to be discovered in order to keep the "wheels of industry turning". To a large extent consumer credit became that means, as it became the handmaiden of the industrial system, i.e., the means whereby goods were kept moving from the factories into households.
- (30) Quoted in Richard Y. Giles, Credit For The Millions, (Harper and Brothers, 1953), p. 99.

(31) The "fundamentalist of thrift" during the 1920s considered the following items as sources of waste in personal budgets: "intoxicating liquors, tobacco, jewelry and plate, automobiles, confectionary, soft drinks, tea and coffee, millinery, patent medicines, chewing gum". Quoted in "Bankers and Thrift in the Age of Affluence," A.L. Roe, American Quarterly, Winter 1965.

(32) The entry of banks into the consumer credit market resumed and grew after World War II as the automobile and a large assortment of consumer goods were brought to the market. If not for the impact of the depression it is quite possible that would have entered full fledged into the consumer credit market long before they actually did.

(33) Roy Bergengren, CRUSADE, (Exposition Press, 1952), pp. 17-34 provides a perspective with respect to the social benefits of credit unions.

(34) Richard Y. Giles, Credit For The Millions, (Harper & Brothers, 1951), pp. 96-97.

(35) John O'Sullivan and Edward F. Keuchel, American Economic History: From Abundance To Constraint, (Watts Publishing, 1981), pp. 163-165. See also Historical Statistics, Part II, Series X 551-560.

(36) Ibid., O'Sullivan and Keuchel.

(37) Cecil R. Crews, History of the Michigan Credit Union League, (Wayne State University Press, 1971), pp. 116-121.

(38) The following is drawn primarily from Joseph L. Snider Credit Unions In Massachusetts, (Harvard University Press, 1939).

(39) For an analysis of the Federal Government during the Great Depression see Albert W. Niemi U.S. Economic History: A Survey of the Issues, (Rand McNally, 1975), pp. 283-289. See also Cary E. Brown, "Fiscal Policy in the Thirties: A Reappraisal," American Economic Review, December 1956.

(40) The following analysis is drawn from data in the Federal Credit Union Annual Reports, 1936-1945.

(41) FEDERAL CREDIT UNIONS: ANNUAL REPORT OF OPERATIONS 1941, p. IX, Federal Deposit Insurance Corporation.

(42) Ibid., 1942.

CHAPTER 5

Credit Union Growth and Maturity: 1946-1970

Consumer installment credit first appeared in the late 19th century. It blossomed in the consumer markets of the 1920s and then became entrenched as an integral component of the American economy. Expansion in the market for household credit and saving was, as indicated in the previous chapter, interrupted by the depression of the 1930s and then suppressed during the war years. With the ending of World War II and the twenty-five years of subsequent prosperity, consumer expenditures and hence consumer credit expanded vigorously.

The years from 1945 until 1970 were relatively prosperous in terms of economic growth. The opening section of this chapter delineates the sources of prosperity which lasted from 1945 until the late 1960s. Prosperity was in part stimulated by growing consumer demand, particularly growth in consumer durables. At the same time, these economic conditions induced further growth in consumer spending. The low rates of unemployment and inflation (relative to the 1970s and early 1980s), and growing real wages and salaries allowed the American worker to consume greater quantities of goods while still increasing his/her savings. As a result, the market for consumer savings and credit expanded greatly.

Competitive stirrings in financial markets did not begin until roughly the 1960s. However, the rising short-term interest rates of the late 1950s and improved corporate cash management techniques forced banks to compete more aggressively for savings. In part, banks reacted by offering more attractive large-denomination certificates of deposit to their corporate

customers. Correspondingly, banks also entered into the retail financial services market by competing for household savings and consumer credit. By the late 1960s, inflation, coupled with tight monetary policy, heightened competition for funds in financial markets and, as a result, banks, credit unions, and thrift institutions experienced their first episode of disintermediation in 1966. The Annual Reports of the Bureau of Credit Unions of the late sixties indicates, however, that credit unions were for the most part insulated from dramatic shifts produced by these financial market conditions and, as such, did not experience as drastic an outflow of savings as did banks and thrifts. Only the larger credit unions, where the larger share account balances (i.e., those in excess of \$5,000) were concentrated, experienced the most severe reductions in savings growth. These larger credit unions reacted by creating new financial instruments (e.g., certificates of indebtedness) to attract and retain funds as well as increasing their borrowings from other financial institutions.

As demand for consumer durables grew, so too did the demand for consumer installment credit. Credit unions captured a small, but profitable, share of the consumer credit market. During the 1950s, credit union loans were allocated primarily toward the provision of remedial loans. Beginning in 1955, roughly the same time that automobile sales and sales of consumer durables attained a zenith, a qualitative shift in credit union lending occurred towards financing consumer durable purchases. Credit union's relative slowness to finance the purchases of consumer durables, such as automobiles, stemmed in part from their philosophic orientation inherited from early years and in part by their relatively small size (both in terms of membership and asset size).

The Economy

The conversion from a war to a peace-time economy involved the return of over ten million servicemen to civilian employment and a shift out of the production of war goods to the production of consumer and producer goods. As a result of this influx of surplus labor, many economists feared that the postwar economy would tumble back to the 17.2 percent rate of unemployment of 1939. The federal government reduced its purchases of goods and services, measured in 1958 dollars, by 78 percent, from a peak of \$181.7 billion in 1944 to a low of \$39.9 billion in 1947. Valued in 1958 prices, real GNP declined by 10 percent, from \$361.2 million in 1944 to a low of \$323.7 million in 1948. At the same time, the unemployment rate rose from 1.9 percent of the workforce in 1944 to 3.9 percent in 1947. Attempts to smooth the transition to peace-time production were complicated when war-time price controls were lifted and subsequently caused rapidly escalating prices. Evidence the consumer price index which increased over 30 percent during the two years immediately following the war. (1)

Those who conceived excessive productive capacity as the underlying cause of the Great Depression feared a similar situation could result after the war. This fear proved groundless, however, as the portended economic contraction never materialized. (2) In contrast, the most pressing economic problem during the immediate post-war period (1946-1948) involved curbing inflationary pressures rather than preventing a retrogression to the economic situation of the 1930s. To profit from the enormous and excess demand for consumer products suppressed during the war by the

imposition of Regulation W and fed after the war by large household savings, American industry was pressured to reconvert its production facilities as quickly as possible to the production of consumer goods. As a result, increases in real consumption and investment expenditures offset in large measure the drop in real public sector spending.

During the immediate postwar period, real consumption expenditures, measured in 1958 dollars, grew by more than 20 percent; while spending on consumer durables accounted for more than one half of the increase in consumer expenditures. Real gross domestic investment rose by almost 268 percent. At the same time, real net exports shifted from a deficit of \$5.8 million to a \$12.3 million surplus. The net reduction in real aggregate expenditures therefore totalled \$51.3 million instead of the \$141.8 million decline in government expenditures. (3)

Housing preoccupied the top of the consumer's shopping list. Residential housing construction which had boomed in the 1920s, had become one of the most severely afflicted sectors of the economy during the depression. Some 937,000 housing units had been built in 1925. Eight years later the annual figure declined to 93,000. (4) The housing market, which after years of underproduction, faced an unprecedented demand from millions of returning veterans. New housing starts increased nearly sixfold from 326,000 units in 1945 to a peak of over 1.9 million units in 1950. The introduction of new construction techniques facilitated a tremendous increase in residential construction activity. Such activity was accompanied by only a doubling in the average price of a home, from \$4,625 in 1945 to \$8,450, by 1950. (5)

After some time, automobile manufacturers rushed to convert their plants to passenger automobile production, which had been suspended during the war years. However, problems of supply and strikes delayed rapid expansion of automobile production. Although 2.1 million cars were sold in 1946 and 3.5 million in 1947, excess demand for automobiles still persisted. By 1949, automobile production surpassed the 5 million mark for the first time in automobile history as the supply of autos at last caught up with demand. Throughout the 1950s, auto sales continued their upward trend and attained record heights. Automobile loans were a significant part of the credit union loan portfolio throughout the post-war era. (6)

As a higher proportion of the American population achieved a middle-class standard of living, the demand for consumer durables other than automobiles shifted upward. The output of electrical appliances, such as refrigerators, washing machines, vacuum cleaners, and electric toasters, boomed in the immediate postwar years, plateaued and then began to decline. By the mid-1950s, demand for other appliances, such as air conditioners, dryers, and home freezers began to grow. By 1959, over 90 per cent of electric wired American homes had radios, television sets, refrigerators, and electric washers. The percentage of wired homes with other electrical appliances in 1959 reads as follows: freezers, 22.1 percent; vacuum cleaners, 72.5 percent; dryers (electric and gas), 17.8 percent; air conditioners, 12.8 percent. (7)

Gross National Product (GNP) grew very rapidly from 1948 to 1956 and then displayed a markedly slower rate of growth during the 1956 to 1963 period. Over the entire period from 1948 to 1963, real GNP rose over 70

percent; during the intermittent period from 1948 until 1956, real GNP increased at an annual rate of 4.7 percent as opposed to an 3.3 percent annual growth rate from 1956 until 1963. During the entire fifteen-year period, the economy experienced four minor recessions, in 1948-49, 1953-54, 1957-58, and 1960-61. Moreover, the rate of unemployment, though relatively low by pre-World War II standards, persistently drifted upward. The rate of unemployment averaged 4.3 percent from 1948 to 1956, and 5.6 percent from 1957 to 1963. In spite of the recessions and rising unemployment, the period was marked by a remarkable degree of stability in the sense that no major economic slumps occurred. (8)

The forces stimulating GNP growth in the 1948 to 1956 period and their ultimate waning in the 1956-63 period are indicated in Table 5.1. During the former period gross fixed investment proceeded at a healthy rate and then grew only half as fast during the latter period. The purchase of consumer durables expanded at a tremendous rate during the earlier period and then experienced a slower annual rate of growth during the later period.

Table 5.1

Mean Annual Percentage Increase in Real GNP Components

GNP Component	1948-56	1956-63	1960-69
Gross Fixed Private Investment	3.2%	1.4%	5.6%
Total Consumption Expenditures	4.7%	3.7%	5.4%
Consumer Durables	6.9%	4.4%	10.0%
Total Government Expenditures	10.3%	4.1%	6.0%
State/Local Govt Spending	56.8%	40.7%	7.4%
Military Expenditures *	29.3%	4.9%	9.6%
Total GNP	4.7%	3.3%	5.4%

Source: Computed from Historical Statistics, Parts I and II, Series F 47, F 49, F 53, Y 616. * Growth rate in current dollars.

Underlying the boom in consumer expenditures was a changing pattern in personal income growth. The rise in employment and steady increases in productivity yielded a rise in real income per individual. The trend in real income growth, which began during the war years, continued to rise slowly in the postwar decade. In 1956 dollars, average disposable personal income per family increased from \$4,520 in 1947 to \$5,050 in 1955. (9)

National Income, Employment, and Earnings

In terms of the distribution of national income and the sectoral growth of employment (Tables 5.2 and 5.3), the pattern of American economic development during the post-war period tended increasingly toward industrial production. As the number of farmers and the size of the farm population declined, agriculture continued to shrink as a proportion of

total economic activity. In 1945, there were 5.8 million farms in the United States, and by 1964 there were only 3.1 million, a decline in excess of 46 percent or 2.5 million farms in under 20 years. Total farm employment fell from 10 million in 1945 to 6.5 million in 1963. Nevertheless, due to technological innovation and the substitution of mechanized equipment for work animals, farm productivity soared. (10)

Employment in manufacturing industries also declined in relative importance, whereas employment in the tertiary industries--services, retail and wholesale trade, finance and government--increased in significance. The output of all manufacturing industries increased 95 percent between 1945 and 1963, a annual rate of growth of 5.3 percent. However, over the same period the rate of growth in the number of persons on manufacturing payrolls lagged behind the growth in industrial output. The actual number of persons on manufacturing payrolls increased 9.5 percent, or at a mean annual rate of .6 percent per year. This is in contrast to the growth in the number of employees on payrolls in tertiary industries which showed much stronger growth, particularly in the construction sector, the wholesale/retail trades, government, and the finance/insurance/real estate sectors. Consequently, by the late 1950s, the share of employment and income originating in the manufacturing sector began to shrink, while tertiary industries, most notably services and government, accounted for an increasing proportion of national income and employment. (11)

Table 5.2

Percentage Distribution of National Income,
by Sector: 1945, 1956, 1963, 1969

Sector	1945	1956	1963	1969
Agric/Forestry/Fisheries	8.4%	4.4%	3.9%	3.2%
Mining	1.5%	1.9%	1.2%	0.9%
Construction	2.4%	5.3%	5.0%	5.3%
Manufacturing	28.8%	32.2%	29.8%	29.0%
Wholesale/Retail Trade	15.4%	15.6%	15.2%	15.0%
Fin/Ins/Real Estate	7.2%	10.2%	11.1%	11.0%
Transportation	5.8%	4.8%	4.2%	3.7%
Comm/Public Utilities	2.3%	3.6%	4.2%	3.9%
Services	7.8%	9.7%	11.2%	12.4%
Government	20.3%	11.6%	13.4%	14.9%

Source: Computed from Historical Statistics, Part I, Series F 226-237, p. 239.

Table 5.3

Rates of Growth of Employees on Payrolls,
by Sectors: 1945-1963

Sector	1945-56	1956-63	1945-63	1960-69
Mining	-0.2%	-3.4%	-1.3%	-1.4%
Construction	15.0%	-0.2%	9.0%	1.8%
Manufacturing	1.0%	0.2%	0.5%	2.2%
Wholesale/Retail	4.4%	1.2%	3.4%	3.2%
Fin/Ins/Real Estate	4.9%	2.6%	5.1%	3.7%
Trans/Comm/Pub Util.	0.8%	-1.1%	0.0%	1.1%
Services	4.9%	3.9%	5.3%	5.7%
Government	2.0%	3.8%	3.1%	5.1%

Source: Computed from Historical Statistics, Part I, Series D 127-141, p. 137.

The rising post-war standard of living reflected rising real wages, particularly in those industries where wages were relatively low. Table 5.4 shows sectoral growth in average annual earnings per employee on nonagricultural payrolls. American workers realized rising nominal wages in all sectors. Between 1945 and 1963, nominal earnings more than doubled in all sectors except agriculture, forestry and fisheries, where nominal wages and salaries increased 57.4 percent over the 18-year period. The rising nominal wages were dampened somewhat by steady postwar inflation as the consumer price index rose 51 percent from 1945 to 1956, 12.7 percent from 1956 to 1963, and 70 percent over the entire period from 1945 to 1963. Nevertheless, since increases in nominal earnings in most sectors exceeded 130 percent from 1945-63, real annual average income rose considerably over the postwar period.

Table 5.4

Percentage Increase in Average Annual Earnings per Employee on
Nonagricultural Payrolls, by Sector: 1945-1969

Sector	1945-56	1956-63	1945-63	1960-69
Agric/Forest/Fishery	29.2%	21.8%	57.4%	84.7%
Mining	90.9%	24.7%	138.1%	63.2%
Construction	78.7%	29.6%	131.5%	70.7%
Manufacturing	82.3%	29.0%	135.2%	52.3%
Wholesale/Retail Trade	86.2%	28.8%	139.9%	49.8%
Fin/Ins/Real Estate	80.8%	31.9%	138.4%	59.6%
Transportation	87.6%	33.6%	150.6%	60.5%
Comm/Public Utilities	91.2%	37.7%	163.3%	56.6%
Services	75.5%	32.4%	132.5%	69.3%
Government	89.7%	33.7%	153.7%	70.3%

Source: Computed from Historical Statistics, Part I, Series D 739, 740, 741, 753, 755, 761, pp. 166-167.

As the 1950s drew to a close, slowing economic activity raised some apprehensions with respect to the future of economic growth. Thus, the era of American economy gave birth to those economic concerns of slowing GNP growth, rising unemployment, and the "new inflation". The latter can be characterized as that inflationary state that is coupled with unemployment and idle productive capacity.

The economy also experienced two of four postwar recessions during the latter half of the 1950s. Following two and one-half years of expansion, the economy entered its third postwar recession in 1957. The 1957 to 1958

recession differed from its two predecessors because it occurred at a time of rising prices and rising defense expenditures. Moreover, while it was the shortest postwar recession it also proved to be the sharpest recession to that date. Between August 1957 and April 1958, unemployment rose to 7.5 percent of the labor force and industrial production dropped more than 13 percent. While production rebounded in late 1958, the unemployment rate remained at a relatively high level of 6 percent of the labor force. (12)

Another slump followed in 1959, which, in part, was the immediate product of a decline in business inventory investment and a deflationary fiscal policy. Evidence the business investment in inventories which mounted sharply following the 1959 steel strike, only to have that level decline after the first quarter of 1960. Also, the federal budget for fiscal 1960 fell into a surplus position on the order of \$1.2 billion, while levels of consumer credit and the number of commercial bank loans shrank in the face of high interest rates and a reduced money supply. In December 1960, unemployment rose to 6.8 percent of the labor force. The recession bottomed out in February 1961 and economic recovery proceeded steadily under the stimulus of an expansionary fiscal and monetary policy. Gross national product increased at a healthy rate, despite a relatively high rate of unemployment that did not fall below 6.7 percent. (13)

Demographic Changes

Suburban migration, which initially began in the 1920s, resumed following the war. The desire of families to move to the suburbs was given impetus after the war by higher real incomes and guarantees to

ex-servicemen of 95 percent of the value of mortgages by the Veterans Administration (VA). Thus, it can be strongly suggested that the millions of veterans were largely responsible for an almost continual real estate boom that lasted until the end of the 1960s. (14)

The automobile and the truck were principle forces in the relocation of the population from central cities to suburban areas. As more people came to live in the suburbs, firms moved operations from urban sites to locations in the surrounding countryside. Other factors such as racial tensions, schools, and the deterioration of central cities also contributed to the population shift. By 1970, more people were living in the outlying parts of metropolitan areas than in the central cities.

The growth of urban and suburban areas accounted for enormous government outlays in public services (e.g., social overhead systems, schools, etc.; housing, transportation equipment; motor fuel; investment in private industrial and commercial plant and equipment; and a plethora of private service, maintenance and repair services). As previously displayed in Table 5.1, real expenditures of state and local governments increased dramatically over the entire period from 1948 to 1963.

The secular movement from rural to urban areas could not be arrested; however, within metropolitan areas. Outlying suburbs grew more rapidly than the central city areas. During the decade of the 1950s, the population in suburban areas adjoining central cities increased nearly 81.5 percent, whereas the population of central city areas grew only 19.8 percent. By 1960, the proportion of the total US population living in

central cities had increased only slightly. By contrast, 20.9 percent of the US population lived in suburban areas by 1960, as opposed to 13.8 percent in 1950. As indicated in Tables 5.5 and 5.6, the exodus to the suburbs continued into the succeeding decade.

Table 5.5

Population Growth Rates
1960-70 1950-60

Total US Population	13.4%	19.1%
Total Urban Population	23.6%	38.4%
Central City Population	10.3%	19.8%
Suburban Population	44.0%	81.5%

Source: Computed from Historical Statistics, Series A 29, A 82, pp. 11-13.

Table 5.6

Distribution of Total US and Urban Population

	1950	1960	1970
Cent City/Total US	31.9%	32.1%	31.2%
Suburban/Total US	13.8%	21.0%	26.6%
Urban/Total US	45.7%	53.1%	57.8%
Cent City/Total Urban	59.9%	60.5%	54.0%
Suburban/Total Urban	30.1%	39.5%	46.0%

Source: Computed from Historical Statistics, Series A 29, A 83, pp. 11-13.

The Decade of the 1960s

In contrast to the late 1950s, the decade of the sixties was characterized by a downward movement in the rate of unemployment and relatively strong GNP growth. Table 5.1 discloses that the 1960s experienced even more brisk economic activity than the immediate postwar years from 1948 to 1956. Gross private domestic investment, a measure of capital formation, increased at an average 5.6 percent per year during the sixties, as compared to an average of 3.2 percent per year from 1948 to 1956. Indeed, all aggregate expenditures listed in Table 5.1 increased at a higher average rate per year. From 1960 to 1969, the average growth of expenditures on consumer durables exceeded the growth of all other expenditure categories listed. Under these prosperous conditions, the rate of unemployment steadily declined, falling from 6.7 percent of the civilian labor force in 1961 to a low of 3.5 percent in 1969 (See Table 5.7 below). In contrast to the late 1950s, the rate of unemployment became a lesser issue to those economists concerned with the formulation of economic policy.

Entry into the Vietnam Conflict strained the productive of a nearly fully utilized economy and caused a further decline in the rate of unemployment and pushed the rate of inflation and interest rates upward. As a consequence, the last half of the decade witnessed a rising rate of inflation. Whereas the rate of inflation stabilized around 1.3 percent in the early and middle 1960s, in 1969 the consumer price index rose 5.4 percent. Concurrently, wholesale prices remained relatively stable until 1964. In 1965, wholesale prices rose 2.0 percent and ultimately rose 3.9 percent in 1969. Accelerating inflation in turn caused interest rates to

rise. Yields on Treasury Bills (a proxy for short-term interest rates) and on 10-year Government Bonds (a proxy for long-term interest rates) rose steadily throughout the 1960s with a sharp increase exhibited in 1966. Table 5.7 summarizes yearly inflation, unemployment and selected interest rates from 1961 until 1969.

Table 5.7

Inflation, Unemployment, and Interest Rates, 1961-1969

Year	CPI *	WPI *	UR	T-Bill	Govt Bond
1961	1.1%	-.4%	6.7%	2.378%	3.90%
1962	1.2%	0.3%	5.5%	2.778%	3.95%
1963	1.3%	-.3%	5.7%	3.157%	4.00%
1964	1.3%	0.2%	5.2%	3.549%	4.15%
1965	1.7%	2.0%	4.5%	3.954%	4.21%
1966	2.9%	3.3%	3.8%	4.881%	4.66%
1967	2.8%	0.2%	3.8%	4.321%	4.85%
1968	4.2%	2.5%	3.6%	5.339%	5.25%
1969	5.4%	3.9%	3.5%	6.677%	6.10%

Source: Congressional Quarterly, THE US ECONOMY: CHALLENGES IN THE '70S, (Congressional Quarterly), Table II, page 5; and Historical Statistics, Series X 450, X 474.

Notes:

* Indicates average annual rate of change.

Key: CPI: Consumer Price Index
WPI: Wholesale Price Index
UR: Rate of Unemployment
T-Bill: Interest rate on 3 and 9 month
U.S. Treasury Bills
Govt Bonds: Interest rate on 10-year
U.S. Government bonds.

National Income, Employment, and Earnings

The earlier trends in the distribution of national income, employment, and earnings also prevailed during the 1960s. As indicated in Tables 5.2, the primary industries accounted for a steadily declining relative share of national income as did the manufacturing sector. The relative shares of the public sector and the services sector, on the other hand, increased steadily between 1960 and 1969. Other sectors, such as the wholesale/retail trades and contract construction, exhibited little change in their share of national income.

Table 5.3 reveals a slowing of employment growth in almost all sectors during the 1960s, as compared with growth rates experienced over the 1945 to 1963 period. Only in the public, manufacturing, and service sectors did the annual rate of employment growth exceed the growth of the earlier period. Employment continued to decline in mining and accordingly that sector experienced a dwindling share of total nonagricultural employment. (See Table 5.8) Jobs in the construction sector and the combined transportation/communications/public utilities sector increased less than 2 percent per year between 1960 and 1969. Consequently, those sectors experienced a declining relative share of nonagricultural jobs. Manufacturing continued to account for the largest proportion of nonagricultural jobs, albeit its share declined from over 35 percent in 1947 to 30.9 percent in 1960 and 27.4 percent in 1970. Employment continued to shift to the tertiary sectors, as indicated by the rising proportion of jobs accounted for by the government, services, finance/insurance/real estate, and retail/wholesale trades.

Table 5.8

Distribution of Employees on Nonagricultural Payrolls, by Sector: 1947, 1960, 1970

Sector	1947	1960	1970
Mining	2.2%	2.0%	0.9%
Construction	4.5%	5.3%	4.7%
Manufacturing	35.4%	30.9%	27.4%
Comm/Trans/Pub. Util	9.5%	7.4%	6.4%
Whole/Retail Trades	20.4%	21.0%	21.1%
Fin/Ins/Real Estate	4.0%	4.9%	5.2%
Services	11.5%	13.7%	16.5%
Government	12.5%	15.4%	17.8%

Source: Computed from Historical Statistics, Series D 127-141, p. 137.

During the 1960s, average annual labor earnings grew most rapidly in agriculture (84.7%), construction (70.7%), government (70.3%), and services (69.3%). Average annual earnings grew least rapidly in the wholesale and retail trades (49.8%) and in manufacturing (52.3%). Growth of annual average earnings from 1960-69 are included in Table 5.4 above. as compared with the 1945-1963 period, annual earnings growth slowed in all sectors except agriculture. The slower growth rates in wages and salaries notwithstanding, the American worker enjoyed real income growth as the consumer price index rose only 12.2 percent between 1960 and 1970.

Demographic Changes

The total US population and the urban population grew relatively less rapid during the decade of the 1960s. Consistent with the long-run trend towards urbanization, the total US population grew at a relatively slower rate than did the urban population. Thus, by 1970 over 57 percent of the total US population lived in urban areas as opposed to 53 percent in 1960. Within metropolitan areas, the suburban population grew at more than four times the rate of the population in the central city proper. As a result, the share of the total US population living in central cities dropped from 32 percent in 1960 to 31.2 percent in 1970. The share of the total urban population living in suburban areas, on the other hand, rose from 39.5 percent in 1960 to 46 percent in 1970. (see Tables 5.5 and 5.6)

The Structure Of Financial Markets

The structure of financial markets during this period found financial depositories, and financial institutions in general, operating without significant overlap into each other's primary markets. Banks, thrifts, and credit unions all held segmented market shares and served distinct market demands due to the regulatory structure governing them. However, such distinctions began to blur as periods of disintermediation forced all institutions into areas of competitive overlap, both with each other and with various types of nondepository financial institutions. (15)

Economic disturbances were relatively mild during the years after World War II and, from 1945 until 1960, financial markets reflected this

relative stability. In such an environment, commercial banks concentrated primarily on attracting demand deposits that paid little if any return. Moreover, they did not aggressively pursue the consumer savings dollar. In fact, few commercial banks were offering rates that approached the Regulation Q ceiling rates for deposits. Thus, for all intents and purposes, Regulation Q had no real impact on commercial banking. Thrift institutions concentrated their funds on the financing of the housing boom. It was during this time that thrifts realized enormous growth in savings deposits. Meanwhile, credit unions realized exceptional growth in every category.

Historically, the patterns of disintermediation are traceable to fluctuations in economic activity coupled with inflationary pressures. The latter together with intense interest rate volatility and the consequent disintermediation which resulted led to dramatic structural changes throughout financial markets. These structural changes resulted in a blurring of functions among all financial institutions (depository and nondepository). Thus, the term financial services industry evolved as the conceptual replacement to the distinct terms which previously served to define and delineate the various types of financial institutions.

Trends Among Depository Institutions

As discussed in the previous chapter, federal regulation of commercial banking dates back to the Banking Act of 1933. This Act prohibited the payment of interest on demand deposits and authorized the Federal Reserve to establish interest rate ceilings on savings and time deposits for all

Federal Reserve member banks. The Banking Act of 1935 extended these regulations to include all commercial banks. As a result of the new regulatory structure, commercial banking entered into an era of relative tranquility. (16)

The thrift institutions of the post World War II era were essentially a creation of Congress. Thrift industry regulation, and thus thrifts, were constructed in a manner to support the housing industry with the thrifts' interest-earning assets being completely limited to home mortgages and/or government securities. To finance their portfolios of long-term, fixed rate mortgages, thrifts would attract savings deposits of relatively short-term maturities. The historical difference between the regulation of thrifts as opposed to the regulation of commercial banks was that thrifts were not subject to deposit rate ceilings. (17)

For credit unions, the post war expansion was directed towards extending consumer loans to members. Credit unions were of course limited to the loan and dividend rates which were outlined by the Federal Credit Union Act. (18)

The first sign of weakening in the regulatory structure emerged in the late 1950s, as short-term market interest rates rose to the level of long-term rates. As a result, commercial banks experienced their first post-war bout with disintermediation. To offset the outflow of funds, the Federal Reserve was induced to increase the Regulation Q ceiling limit on deposit accounts. Since a rate differential of substantial magnitude

continued to exist between thrifts and banks, thrifts were not impacted by the increase in ceiling rates. (19)

To counter the outflow of funds, banks turned to the issuance of large denomination negotiable certificates of deposit and, as a result, were able to prevent a further diversion of short-term funds away from demand deposits and into various open-market investment instruments. To compete for consumer savings, banks later offered small-denomination certificates of deposits. With this, banks actively entered the consumer financial market and began to market "one-stop banking" services to consumers as well as an expanded array of consumer loans, which concentrated on the more profitable financing of automobiles and major appliances.

With respect to thrift institutions, the favorable interest rate environment which existed allowed them to borrow short-term funds and in turn lend them on a long-term basis. Moreover, the fact that an increase in short-term interest rates during the late 1950s did not adversely impact thrifts allowed them to continue with their asset composition of primarily mortgages. This was possible due to the fact that short-term deposit rates offered by thrifts were higher relative to the short-term deposit rates offered by banks.

By 1965, conditions began to change rapidly. The dual impact of full-employment and massive government spending produced a relatively strong inflationary trend. Market interest rates rose above the legal ceilings that could be paid on deposits which resulted in a reduction of commercial bank deposits and slower growth of time and savings deposits.

Moreover, short-term interest rates frequently rose above long-term rates. In addition, interest rate fluctuations became more volatile. These events marked the second post-war phase of disintermediation, which was distinct in so far as it was the first tight credit episode in which market rates rose above Regulation Q ceiling limits.

This "credit crunch" brought an increase in the maximum rate commercial banks could pay to attract savings deposits. The Federal Reserve increased the limit to 5.5 percent on time deposits and to 4 percent on savings deposits, as compared to the 4.85 percent that thrifts paid on savings. This action led to a large-scale movement of savings out of the thrifts and into the commercial banks and other financial institutions. With short-term interest rates relatively high, borrowing short and lending long ceased to be an exact way to make money. Moreover, with interest rates taking huge swings, thrift institutions and consequently the housing industry were negatively affected. In response, during 1966 Congress enacted legislation enabling the Federal Home Loan Bank Board (FHLBB) and the Federal Deposit Insurance Corporation (FDIC) authority to join with the Federal Reserve Board in controlling the maximum amounts of interest payable on all deposit accounts at thrifts. This action formalized the 1/2 percent interest rate differential paid by thrift institutions relative to commercial bank.

Unlike banks, which were able to diversify their asset portfolio to match the maturity structure of their liabilities, thrifts remained restricted to the borrow short-lend long environment. Indeed, investment regulations prevented thrifts from adjusting their policies to this new

economic situation thereby leaving them highly vulnerable to interest rate volatility.

A second period of extremely tight monetary conditions occurred just three years later. Although inflation had stabilized in 1967, it began to increase again by 1968 and continued to advance in 1969. Recognizing another volatile period was on the horizon, shortly before year-end 1968 the Federal Reserve acted to tighten credit. As a result, market rates rose above the maximum rates that were permitted under Regulation Q, and both banks and thrifts experienced the pressures of disintermediation once again.

Consumer Savings

During the 1950s, commercial banks steadily lost their share of time and savings deposits to other depository institutions, particularly thrift institutions. With the modification of Regulation Q and the more aggressive marketing efforts, commercial banks not only stabilized their market share of consumer savings but increased it from 40.1 percent to 46.1 percent by 1970. Correspondingly, the market share held by savings and loan associations fell from 36 percent in 1960 to 33.8 percent by 1970. Meanwhile, credit unions increased their market share from 2.9 percent in 1960 to 3.6 percent in 1970. However, mutual savings banks were alone among the depository institutions that failed to grow substantially. (20)

Consumer Credit

Starting from a base of \$5.6 billion at the end of 1945, consumer credit expanded rapidly through the mid-1950s, frequently recording increases greater than 20 percent. The underlying factor driving total consumer credit upward was the rapid expansion in consumer installment credit. In 1946, for instance, consumer installment credit grew nearly 70 percent and in 1947, it increased 61 percent. In terms of aggregate consumer credit, the share of consumer installment grew throughout, rising from 43.5 percent at year-end 1945 to 76.5 percent by 1959. (21)

As previously discussed, several factors contributed to the upsurge in consumer borrowing during the immediate postwar decade. Wartime controls on production and consumer credit, artificially low inventory levels of consumer goods at the war's end, and pent-up of consumer demand for durable consumer goods were majors factor in the expansion of the economy. Finally, an increase in family formation during that period further stimulated outlays for consumer durables.

A significant factor in the upward surge in consumer borrowing/purchasing was the changing attitudes on the part of both borrowers and creditors. While rooted in the 1920s, and suppressed during the the depression and World War II, the consumer persisted in the belief that goods that were once treated as luxuries should be considered necessities. Thus, automobile credit became a significant component in total consumer installment credit outstanding. In 1945, automobile credit stood at 18.4 percent of total consumer installment credit, by 1960, the

share of automobile credit rose to 41.1 percent. Installment debt also started to be employed for a wider variety of purposes.

The adoption of the 36-month car loan (the previous standard was 24 months) was a principle force underlying the increase in new car sales in 1955. Automobile credit increased nearly 37.2 percent during 1955. A substantial lengthening of maturities on new loans also contributed to the growth of outstanding debt during this period. (22)

After the initial post-war surge in consumer debt issuance, there occurred a marked deceleration in the rate of consumer credit expansion from the mid-1950s through the 1970s. In large part, this deceleration reflected moderation in the forces which initially stimulated consumer spending, which included households that had accumulated substantial stocks of consumer durables as well as a reduction in the number of new families formed. In addition, financial institutions' average loan maturities were lengthening at a slower pace.

As detailed, financial institutions expanded their involvement in the consumer lending arena. Whereas, prior to the war the bulk of consumer credit was supplied by finance companies, after the war consumer credit was supplied primarily by banks and credit unions. In 1940, the share of installment credit held by banks amounted to only 26.3 percent as compared to 41.3 percent held by finance companies. Credit unions held a mere 3.1 percent share and retailers accounted for 25.9 percent. In 1950, banks held 39.4 percent of outstanding consumer installment credit; finance companies held 36.1 percent; retailers held 17.8; and credit unions held 4

percent. By 1960, the percentage share held by banks reached 38.8 percent and the percentage held by credit unions reached 9.1 percent. During this same period, both finance companies and retailers share of the market declined, as the former dropped to 35.9 percent, while the latter fell to 13.8 percent. As of 1970, the share of installment credit held by banks increased to 44.6 percent; whereas the share held by finance companies declined to 27 percent. Credit unions increased their share to 12.7 percent, while retailers dropped to 13.4 percent. (23)

Federal Credit Unions: 1946-1970

Vigorous credit union growth marked the greater part of the years from 1945 to 1970. The wartime decline in the number of FCUs and FCU membership reversed as assets, shares and loans displayed sharp upward trends over the immediate postwar period. Nevertheless, credit unions remained quite simple in their financial operations as they continued to balance member savings against member loans and investments, with interest rate spreads virtually guaranteed. Thus, sophisticated financial management on the part of credit unions was not required. (24)

Numbers and Members

Beginning in 1946, the decline in the number of FCUs reversed and by year-end 1947 there were 5,410 FCUs chartered. Of these, the occupational credit union continued to dominate in terms of the distribution of the total number of FCUs (occupational credit unions comprised 83.6 percent, associational credit unions comprised 13.5 percent, and residential credit

unions accounted for 2.9 percent of all FCUs in 1947). Within the occupational grouping, manufacturing based FCUs held the dominate share with 46.9 percent; governmental FCUs were second with 16.7 percent, followed by transportation, communication, public utilities FCUs with 14.5 percent of all occupational FCUs.

By 1960, the number of FCUs chartered reached 10,374, an increase of nearly 92 percent over 1947. The occupational grouping continued its dominance with an 82.9 percent share of the total number of FCUs. Associational FCUs reached 15.1 percent while residential FCUs stood at 2 percent. In general, the relative shares of the occupational grouping continued to follow the same distribution until 1962, at which time the service industry based FCUs overtook transportation, communication, public utilities based FCUs, as the share of the former increased to 14.1 percent and the share of latter fell to 11.4 percent of total occupational based FCUs.

Between 1960 and 1970, the number of FCUs continued to increase as they rose to 13,555, a 30.6 percent increase over 1960. The share of occupational based FCUs dropped to 80.3 percent, while the shares of both associational and residential FCUs reached 15.7 and 3.9 percent, respectively. Trends within the occupational grouping displayed a continued growth in the service sector based FCUs as their share reached 16.7 percent of the total number of occupational based FCUs. Transportation, communication, public utilities based FCUs continued their relative decline, falling to 9.9 percent of the total number of occupational based FCUs.

FCU membership increased throughout the period as the number of members rose from a 1946 level of 1.3 million to a 1960 level of 6.1 million, an increase of 369 percent. By 1970, the number of FCU members increased to 12 million, a increase over the 1960 level of 96.7 percent. Over the long-term, 1946-1970, FCU membership increased 823 percent. The distribution of FCU members followed roughly the same pattern as the distribution of FCUs. The occupational based unions had the most members, with associational next, followed by residential FCUs. Within the occupational grouping, however, a shift occurred in the relative distribution of occupational based FCUs. Whereas, in 1946, membership in manufacturing based unions comprised 50.5 percent of total occupational FCU members, by 1970 its relative share fell to 34.7 percent. The transportation, communications, public utilities FCUs also declined in relative importance as its share of FCU members fell from 19.4 percent in 1946 to 10 percent in 1970. In sharp contrast, governmental based FCUs experienced steady growth in its share of total occupational FCU membership. Their share increased from 15.8 percent in 1946 to 36.5 percent by 1970. Service sector FCUs also experienced an increase, albeit a relatively modest one, rising from 5.4 percent in 1946 to 10.9 percent by 1970.

The interaction between growth in the number of FCUs and in the number of FCU members, in turn, brought about a steady increase in the average number of members per FCU throughout the period under review. Thus, in 1946, the typical FCU had an average of 346 members; by 1960, this figure reached 615 members per FCU; and, by 1970, the number of members per FCU

stood at 922. In terms of long-run growth, membership per FCU increased 166.5 percent from 1946 to 1970.

In 1946, the largest FCUs were operating under the transportation, communication, public utilities common bond, with an average number of members per union of 439 followed by manufacturing credit unions which had 405 members per establishment. The least number of members per FCU were in the residential based group, as they averaged only 184 members per union. By 1970, the situation changed dramatically. Governmental FCUs grew to serve an average of 1,978 members per union. Transportation, communications, public utilities FCUs experienced an increase, rising to 1,008 members per union, while manufacturing FCUs reached 650 members per union. In summary, FCUs grew not only extensively in the sense of being more numerous, but intensively as the average number of members per FCU rose each year over the entire twenty-five year period.

Assets-Liabilities

Assets-liabilities increased tremendously, rising from \$153.1 million at year-end 1945 to over \$8.8 billion at year-end 1970, a growth of 5,687 percent. These trends, coupled with trends in the number of FCUs, as described above, indicate that the average assets-liabilities per FCU continuously increased throughout. By year-end 1946, the typical FCU had \$46 thousand in assets-liabilities. By 1960, assets-liabilities per FCU reached \$269 thousand, an increase of approximately 485 percent. By 1970, the average level of FCU assets-liabilities was \$682 thousand, a 153

percent increase over the 1960 level. From 1946 to 1970, assets-liabilities per FCU increased 1,382 percent.

As seen with the number of FCUs and the number of FCU members, the bulk of FCU assets-liabilities were concentrated in occupational credit unions. In 1946, occupational FCUs held 91.6 percent of total FCU assets-liabilities; by 1960, they held 91 percent; and by 1970, their share reached 92.2 percent. The share of assets controlled by the associational and residential FCUs stood at 7.4 and .8 percent, respectively, in 1946. During the 25 years under review, the share of assets-liabilities held by associational FCUs continually declined and reached 6 percent by 1970; residential credit unions increased their share to 1.8 percent by 1970. Within the occupational grouping, manufacturing based FCUs held over 50 percent of occupational FCU assets-liabilities in 1946, while transportation, communication, public utilities and the governmental FCUs held 19 percent and 14.9 percent, respectively. Throughout the years following 1946, the share of assets-liabilities held by manufacturing based FCUs continually declined, reaching a low of 39.8 percent in 1970. In sharp contrast was the trend in the overall share held by governmental FCUs, which increased from 14.9 percent in 1946 and stood at 33.6 percent of total occupational FCU assets-liabilities in 1970.

In 1946, the transportation, communication, public utilities FCUs were the largest in terms of the average asset-liability level per FCU, with a \$53.4 thousand average. The manufacturing based FCUs followed with \$52.7 thousand in assets-liabilities per establishment. The wholesale/retail based FCUs had an average size of \$41 thousand, and governmental FCUs were

\$37.3 thousand per FCU establishment in 1946. Associational and residential FCUs were relatively small, the former having an average \$11.7 thousand in assets-liabilities, and the latter only \$7.6 thousand per union. By 1970, however, the situation changed dramatically. The greatest asset-liability levels shifted towards the governmental unions, as they reached an average \$1.4 million per establishment. Occupational FCUs had an average asset-liability level of \$777.7 thousand, while associational and residential FCUs reached an average asset-liability size of \$269.2 and \$316.6, respectively. Agricultural industry based FCUs, which were added to the 1962 FCU statistical report, had an average asset-liability level of \$954.8 thousand. Transportation, communication, public utilities FCUs reached an average asset-liability level of \$862 thousand.

Composition of Assets

The end of the war years involved a shift in the composition of assets, as loans to members rose at the expense of investments. Whereas, in 1945, 62.4 percent of total assets were held as investments, by 1946, the investment/asset ratio had fallen to 53.4 percent. The loan/asset ratio, on the other hand, increased from 23 percent to 32.8 percent. This portfolio restructuring represented a shift from liquid government obligations and shares in savings and loans to the more lucrative personal loans. Throughout the decade of the 1950s, investments ranged from 20 to 25 percent of total FCU assets. With the sharp upturn in loans over 1960, investments fell off further, dropping to 17 percent of total assets. By 1970, investments had fallen to 14.9 percent. Table 5.9 indicates the

growing proportion of total assets held as loans to FCU members, accompanied by a decrease in the ratio of investments to total assets.

Table 5.9

Percent Distribution of Total Assets for Selected Years

Category of Asset	1945	1950	1960	1965	1970
Loans to Members	23.0%	65.0%	75.7%	74.8%	78.7%
Cash	14.2%	10.4%	5.9%	5.3%	5.1%
Other Assets	0.4%	0.6%	1.1%	1.0%	1.4%
Investments	62.4%	24.0%	17.3%	18.9%	14.9%
U.S. Government Sec.	50.3%	16.0%	3.5%	2.0%	2.3%
Federal Agency Sec				0.2%	3.8%
S&L Association Shares	11.8%	6.4%	11.5%	15.0%	2.6%
Loans to other CUs	0.3%	1.6%	2.3%	1.7%	1.2%
Shares/Deposits in CCUs					0.9%
Common Trust Investments					4.2%

Source: Computed from Federal Credit Union Annual Reports.

In the fourteen years from 1950 until 1964, Federal Credit Unions substantially increased the proportion of their investments held in the form of savings and loan shares and decreased their holdings of U.S. Government securities. During the late 1960s, legal developments broadened the range of allowable investments. Investments in Federal Agency securities were authorized under the 1964 amendments to the Federal Credit Union Act. Legislation in 1968 authorized purchases of shares in central credit unions for the first time. As a result, FCUs diversified their investments in both U.S. government obligations and savings and loan association shares. The proportion of investments in the form of loans to other credit unions fluctuated somewhat, but remained relatively low during the period.

Loans Outstanding

Loans outstanding grew more rapidly than total assets, as the former increased from \$35.2 million in 1945 to over \$7 billion by 1970, an increase of over 19 thousand percent. The most rapid period of growth occurred following the war. With the lifting of the restrictions on consumer lending and buying, loans outstanding increased 650 percent between 1945 and 1950. After only a 2.2 percent increase in 1945, loans outstanding rose 61.6 percent in 1946; 60.9 percent in 1947; and 50.6 percent in 1948.

The relatively rapid loan growth was reflected in a rising ratio of loans to total assets, by an increase in the average loan size, and, as expressed above, a rising ratio of loans to shares. The ratio of loans to total assets rose from 23 percent in 1945 to 65 percent in 1950. In the years from 1950 until 1970, the ratio of loans outstanding to total assets continued to rise, though less dramatically so. By 1960, loans accounted for 75.7 percent of total assets; by 1970, they accounted for 78.7 percent of total assets. At the same time, the ratio of loans to shares (the primary source of funds) rose from 25 percent in 1945 to 72.9 percent in 1950, and to 86 percent and 91.4 percent in 1960 and 1970, respectively.

The total amount that can be lent by a credit union obviously is dependent on its total asset size. Thus, in comparing credit union lending trends, it can be generally misleading to analyze the total dollar amount of loans outstanding. A better measure to compare the level of consumer credit extended is the loan-to-asset ratio. This ratio reflects the

proportion of credit unions assets which are dedicated to servicing member credit needs.

In 1946, the ratio of loans outstanding to total assets varied substantially between the occupational based FCUs and both the residential and associational FCUs. Whereas the occupational FCU had an average loan/asset ratio of 31.7 percent, the residential union's loan/asset ratio stood at 40.8 percent while the associational union had a loan/asset ratio of 45.1 percent. Within the occupational grouping, loan/asset ratios ranged from a low of 23.4 percent in the wholesale/retail based unions to a high of 37.9 percent in the transportation, communication, public utilities based FCUs. This disparity, however, narrowed by 1960, as the three general bond types had loan/asset ratios in the 75 to 78 percent range. Curiously, the wholesale/retail based unions continued to have the lowest loan/asset ratio as they stood at only 73.1 percent. By 1970, the loan/asset ratios were even more similar as they ranged from 77 to 79 percent across the three general bond types. Within the occupational grouping, the agricultural based unions had the lowest loan/asset ratio in 1970, as they were only lent out up to 54.7 percent of total assets. This figure signifies the seasonal nature of loans to the farm community. For example, farmers borrow more heavily in the spring to finance the current season. With the fall harvest, loans are generally paid off. Consequently, it must be recognized that the cyclical variations in borrowing trends are not apparent when using year-end data.

Throughout this period, the average loan size increased substantially, as loans outstanding per member (as opposed to loans outstanding per

borrower) rose from \$29 in 1945 to \$332 in 1960 to \$582 in 1970. Increases in loans outstanding and in average loan size can be attributed to three basic factors: First, such a trend reflects rising prices levels, which necessitates greater nominal expenditures; second, rising loans reflects borrowing to finance purchases of more expensive, durable consumer goods; finally, the Federal Credit Union Act was amended in 1959 to increase the maximum allowable loan maturity from 3 to 5 years and raise the limit on unsecured loans from \$400 to \$750. Later amendments to the Federal Credit Union Act in 1968 increased the maximum amount of unsecured loans from \$750 to \$2,500 and extended the maximum maturity on secured loans from 5 to 10 years.

Loans per member were highest in the associational based unions, as they stood at \$53 at year-end 1946. Residential FCUs and occupational FCUs were surprisingly similar, as the former averaged \$42 per member and the latter averaged \$43 per member by year-end 1946. Within the occupational grouping the average level of loans outstanding at year-end 1946 ranged from a low of \$30 per member in the wholesale/retail and miscellaneous occupational groups, to a high of \$50 per member in the transportation, communication, public utilities grouping.

The average level of loans per member in the occupational FCUs surged ahead by 1960, as they reached \$339 per member. Residential FCUs averaged \$305 per member and associational FCUs fell in a relative sense, as they stood at \$269 per member by year-end 1960. The FCUs within the occupational grouping all had average size loans in the \$290 to \$375 range, with the miscellaneous group at the low end with \$292 per member, and

transportation, communication, public utilities at the high end with \$373 per member. In 1970, the occupational group continued to make the largest average loans per member at \$604. The residential and associational FCUs stood at \$418 and \$401, respectively. The contract construction group were the highest within the occupational grouping, averaging \$872 per member, while the lowest continued to be the miscellaneous group, as their loans per member actually fell to \$194.

Composition of Liabilities

The following table shows that member shares provided the bulk of credit union funds from 1945 through 1970. Even so, a noticeable shift occurred from member shares toward reserves and undivided profits as a source of funds. This shift, in turn, reflects the maturing of credit unions as financial institutions. As will be seen in the following chapter, this process has brought credit unions to the point where they no longer are merely an extension of the economic and financial goals of their members.

Table 5.10

Percent Distribution of Total Liabilities for Selected Years

Liability	1945	1950	1960	1965	1970
Shares	91.8%	89.2%	87.8%	87.8%	86.1%
Accounts payable	1.2%	0.4%	0.4%	0.6%	1.0%
Notes Payable	0.7%	3.3%	2.7%	1.8%	2.6%
Regular Reserve	3.1%	3.0%	4.2%	5.2%	6.0%
Special Reserves *	0.1%	0.1%	0.2%	0.1%	0.1%
Other Reserves **			0.2%	0.4%	0.5%
Undivided Earnings ***	2.5%	4.1%	4.5%	4.1%	3.7%

Source: Calculated from Federal Credit Union Annual Reports.

Notes:

* Special reserves for delinquent loans.

** Reserves for contingencies and reserves for losses.

*** Undivided earnings are calculated before payment of year-end dividend.

Member Savings

Savings in FCUs grew at a pace slightly less than the growth in total assets-liabilities, increasing 5,324 percent, from \$140.6 million in 1945 to \$7.7 billion by 1970. Consequently, shares as a percentage of total liabilities fell from 91.8 percent in 1945 to 87.8 percent in 1960. By 1970, the share/asset ratio had fallen to 86.1 percent. Since asset-liability growth was motivated primarily by the growth in member savings, the trends described above concerning the growth in assets-liabilities reflect the trends in member savings. This is true with respect to both aggregate member savings and savings by general common bond

type. Further elaboration on basic trends would add little of import to the presented analysis. Consequently, emphasis turns to an analysis of savings per member, in the aggregate and by common bond type.

In 1946, the average level of savings per member for all FCUs stood at \$123. By 1960, average savings reached \$368 per member, an increase of 199.2 percent. By 1970, average savings climbed to \$638 per member, an increase of 73.4 percent. Of the three general common bond types, members of the occupational bond FCUs saved the greatest amount in 1946, \$124 per member. This compared to \$108 per member for associational FCUs and \$94 per member for residential FCUs, which was the lowest for all FCU types. By 1970, the occupational group reached a level of \$662 in savings per member, whereas the associational and residential FCUs stood at \$442 and \$452 per member, respectively.

Within the occupational grouping, manufacturing based FCUs had the greatest amount with \$130 in per member savings. Service sector FCUs followed with an average savings level of \$126 per member. The lowest level of savings per member in the occupational group was the finance/insurance sector, with an average savings level of \$106 per member. By 1970, the common bond type with the greatest average level of savings per member was agriculture, with an average of \$1,272 per member held in savings. Construction based FCUs followed with an average level of \$993 per member. The manufacturing group jumped to \$706 per member and the transportation, communication, public utilities group reached an average of \$730 in savings per member.

Earnings

As the proportion of member loans to total assets rose from wartime levels, so to did FCU income and net earnings. Net income rose from \$2.6 million in 1945 to \$15.8 million in 1950, a period during which loans outstanding and the ratio of loan income to total income rose most dramatically. Net income attained \$123.9 million by 1960 and \$477.9 million by 1970.

With an increasing amount of member loans, the return of credit union assets rose. This follows from the fact that in the past member loans provided credit unions with a greater return than an equal amount of funds placed in investment instruments. The ratio of total income to total assets, a measure of the return on assets, increased steadily from 3.7 percent in 1945 to a high of 8.7 percent in 1970. The ratio of total expenses to total assets, a measure of cost efficiency, showed a much slower upward trend. From a low of 2 percent in 1945, expenses as a percentage of assets rose to a high of 3.3 percent in 1970. As the return on assets rose relative to costs, FCUs experienced a rising profit rate (i.e., the ratio of net income to total expenses). The profit rate reached 84 percent in 1945 and 156 percent in 1950. In 1960, FCUs earned 148.7 percent on their expenses and, by 1970, the rate of profit attained a post-war high of 163.8 percent.

Thus, member loans proved to be the mainstay of a FCU's profitability. As credit unions increased the proportion of their assets held as loans, net income and net profitability also increased. As a result of the enhanced profitability of their asset portfolio, FCUs were able to realize an increase in their ratio of capital (undivided earnings plus reserves) to

total assets-liabilities. Capital accounted for 5.6 percent of total assets-liabilities in 1945, as opposed to 7.2 percent in 1950, 8.7 percent in 1960, and 9.7 percent in 1970.

With respect to general FCU types, the data shows that, from 1946 to 1970, all FCU types had capital/asset ratios that fell into a relatively narrower range. For example, in 1946, the capital/asset ratios for associational, residential, and occupational unions were 5.4 percent, 4.8 percent, and 5.6 percent, respectively. In 1970, the capital/asset ratios stood at 9.8 percent, 9.6 percent, and 9.7 percent, respectively. The FCU types within the occupational grouping also follow similar trends. Thus, no matter what type of credit union is discussed, the capital/asset ratio displayed similar trends.

Qualitative Aspects of FCU Loans

A marked transformation in the purposes for which credit union loans were made occurred during this period. On the one hand, in the immediate postwar years, credit union reports indicate that lending was comprised largely of remedial loans. In 1948, the Bureau of Federal Credit Unions issued questionnaires to all operating FCUs enquiring as to the purpose for which loans were extended. The three most often cited reasons were: "To pay current living expenses" (16.1 percent of number of loans, 9.6% of dollar amount of loans); "Loans to pay medical expenses" (15.3 percent of the total number of loans, 10.3 percent of the total dollar amount of loans); and "To consolidate debts" (15.4 percent of number of loans and 14.9 percent of dollar amount of loans).

The early altruistic conception of credit unions lingered into the decade of the 1950s. The Annual Reports of the early 1950s underline the functions of credit unions as promoting thrift and providing an affordable source of borrowing. Further, the primary objective of a credit union was to promote the financial welfare of its members via systematic programs of savings and providing members a source of relatively inexpensive credit. As stated in the Report of Federal Credit Union Operations in 1950,

"Loan service is a short-run supplementary factor in the over-all objective of improving the financial condition of members and their families, and a majority of Federal credit unions urge that borrowing members add to their share balances as they repay their loans." (25)

Consumer expenditures, in general, and spending on consumer durables in particular, rose dramatically during the course of the 1950s. The Report indicates that members began financing their consumption expenditures through their credit unions. The 1956 Annual Federal Credit Union Report noted a shift in the purpose for which members borrowed as compared with 1948. In particular, the Report found that FCU members increasingly borrowed to finance purchases of consumer durables and less so for remedial purposes. In 1948, loans to purchase consumer durables composed 15 percent of all loans and 28.1 percent of the dollar amount of loans extended by FCUs. Automobile lending accounted for 21.3 percent of the total dollar amount, but comprised only 7.5 percent of all loans. In 1956, by contrast, one-third of all loans were made to finance purchases of consumer durables. Automobile loans accounted for 13 percent of the total number of loans granted in that year. Medical expenses dropped to 10 percent of the loans made in 1956, and loans made to finance living expenses fell to 6 percent of total loans. Borrowing to consolidate debts accounted for 15 percent of all member loans in 1956. (26)

Data regarding the purposes for which members borrowed appeared again in the 1970 report. By that year, durable goods accounted for 33.9 percent of all loans and 41.4 percent of the total dollar amount of loans. Automobile loans accounted for 21.1 percent of the number of loans and 29.2 percent of the dollar amount of loans. The average new car loan was \$2,896 and the average used car loan was \$1,463. The next largest durable goods loan category was furniture, home furnishings, and household appliances, which accounted for 7.9 percent of the number and 6 percent of the dollar amount of loans made. Personal, household, and family expenses accounted for 54.4 percent of the number and 42.5 percent of the dollar amount of all loans. Within that category, debt consolidation was the most significant category, accounting for 15 percent of the number of loans and 13.5 percent of the total amount.

In spite of the growing prominence of loans to finance durable goods, most credit union loans in 1970 were extended for short periods of time. More than three-fifths of the total number of loans, accounting for a little more than one-third of the amount, had maturities of under two years. Personal loans constituted the majority of these short-term loans. Another 29 percent of the number and 44 percent of the amount of loans carried maturities of 25 to 36 months. Most of these loans financed automobile purchases. The long-term loans (of maturity exceeding 5 years) constituted 3 percent of the number of loans made. These were primarily large, secured loans used to finance purchases of real estate, boats and mobile homes, and for the repair and modernization of residential property.

In spite of their explosive growth, credit unions remained a relatively small part of the total consumer credit and saving market. For the ten-year period from 1954-64, FCU loans outstanding rose at an annual rate of about 18 percent, nearly twice that of any other major lender. Despite this rapid rate of growth, FCUs held only 6.4 percent of total short and intermediate-term consumer installment credit of all financial institutions at the end of 1964. Shares in FCUs also grew at relatively rapid rates during 1954-64, compared with the expansion in consumer savings accounts at other financial institutions. The 16.3 percent average annual increase at FCUs from 1954-64 compares with a rate of 14.5 percent in shares at savings and loan associations. In spite of their growth, at the end of 1964, Federal credit union shares made up less than two percent of total consumer savings accounts. (27)

Clear differences in types of loans extended by financial institutions are noted in the 1965 Report. More than two-thirds of the consumer installment credit held by commercial banks financed purchases of durable goods, as opposed to two-fifths for credit unions in 1965. The disparity was explained by the fact that overwhelmingly small credit unions lacked the necessary resources to finance such relatively expensive goods. In 1965, 45 percent of FCUs had assets of less than \$100,000. Twenty-seven percent of consumer installment credit extensions by banks in 1965 were "personal" loans, (i.e., for household, family and other personal expenditures) as opposed to one-third of FCU loans. (28)

FCU Response to Financial Market Conditions: 1966-69

Inflation and rising market interest rates made credit conditions tight in 1966 and again in 1969. Growth in consumer installment lending and consumer savings had slowed at all major financial depositories in 1966. Share growth in credit unions fell off to 8.9 percent in 1966, as opposed to 13 percent in 1965 and 16.4 percent in 1964. Annual growth in loans to members fell from a high of 15.4 percent in 1965 to 11.9 percent in 1966 and 8.2 percent in 1967. With the inflow of savings reduced, FCUs were forced to meet members credit demands by reducing their shareholdings in savings and loan associations, curtailing their use of funds in other major types of investments, and by borrowing. As a result, investments rose only 1.5 percent in 1966, as opposed to a 7.4 percent increase in 1965 and a 12.3 percent increase in 1967. Annual growth in total income also fell from 14.8 percent in 1965 to 12.5 percent and 10.4 percent in 1966 and 1967, respectively.

The accelerated inflation environment and increased competition among financial institutions for consumer savings forced FCUs to increase their dividend rates. Table 5.12 depicts the marked increase in dividend rates among Federal credit unions. Whereas, in 1960, only 6.7 percent of all operating credit unions paid a dividend of 6 percent on shares, in 1970, over 17 percent of all operating credit unions paid dividends of 6 percent. In order to pay higher dividends on shares, FCUs curtailed interest refunds on loans to borrowers. In 1966, 20.7 percent of all operating Federal credit unions paid interest refunds, the median refund paid being 10 percent. By 1970, 17.6 percent of all FCUs paid interest refunds, the median refund being again 10 percent.

Table 5.10
Percentage Distribution of Operating FCUs
Paying Dividends, by Rate

	Year						
	1960	1965	1966	1967	1968	1969	1970
% of Operating FCUs	88.9%	90.5%	89.3%	89.5%	86.5%	86.5%	87.0%
Dividend Rate							
Under 3%	2.6%	2.2%	2.7%	1.9%	1.5%	1.4%	1.4%
3-3.9%	13.0%	7.2%	4.7%	4.6%	4.0%	3.3%	2.8%
4-4.9%	43.8%	50.3%	37.1%	34.8%	29.7%	20.9%	14.1%
5-5.9%	22.8%	33.9%	38.0%	41.1%	43.6%	49.7%	50.8%
6%	6.7%	6.5%	6.8%	7.1%	7.7%	11.6%	17.9%

Source: Federal Credit Union Annual Reports.

In 1969, the inflation pressures intensified despite monetary and fiscal restraint, and interest rates attained their highest known levels. Large FCUs (i.e., in terms of assets) experienced operating pressures associated with a reduction in liquidity and rising expenses. As a group, FCUs tended to adjust to the inflationary and tight monetary conditions of 1969 by raising interest charges on loans to--or in the direction of--the 1 percent per month maximum. During 1970, almost 75 percent of all loans granted by FCUs were extended at the 1 percent per month maximum, up from 69 percent in 1968 and 1969. As already noted, FCUs also continued this practice of reducing interest refunds in order to pay higher dividends.

Credit unions came increasingly more reliant upon borrowed money to meet loan demand, albeit member shares still provided the primary source of

loanable funds. This increasing reliance on borrowed money is reflected by the rising share of total expenses accounted for by interest on borrowed money. In 1965, interest on borrowed money accounted for 2.9 percent of total expenses, as opposed to 4.6 percent in 1970.

At the same time, an increasing number of large credit unions issued Certificates of Indebtedness (CI's), both to retain their existing share capital and/or to attract new capital to meet their expanding loan needs. In 1969, the Bureau of Federal Credit Unions conducted a survey of credit unions with assets exceeding \$1 million dollars. Among those credit unions, the number issuing CIs increased from 21 in 1968 to 155 in 1969. In terms of dollar amount, \$2.6 million in CIs were outstanding at year-end 1968 as opposed to \$32.2 a year later. Moreover, CIs comprised 46 percent of notes payable of those credit unions issuing CIs. Of total outstanding CIs, 23 percent were held by members in 1968, and 84 percent were held by members in 1969. The CIs increasingly allowed the issuing credit unions to circumvent the 6 percent ceiling on dividends. In 1968, 24 percent of the issuing credit unions paid six percent or more on their CIs, as opposed to 60 percent in 1969.

Debt in the form of notes payable was concentrated primarily among large credit unions. As of December 31, 1969, for example, 72 percent of the total was owed by credit unions with assets exceeding \$1 million. Twenty-two percent of the total debt of large credit unions is represented in outstanding CIs.

Although CIs represented an important source of lendable funds for the credit union which issued them, it should be pointed out that this group consisted of a tiny percent of all Federal credit unions. Most Federal credit unions never adopted this device.

Footnotes

- (1) Historical Statistics, Part 1, Series D 9, D 47, E 135, F 66.
- (2) John O'Sullivan and Edward F. Keuchal, American Economic History: From Abundance to Constraint, (Watts, 1981), pp. 197-198.
- (3) Martin Feldstein, "The American Economy in Transition," The American In Transition, Martin Feldstein, ed., (The University of Chicago Press, 1980), p. 1.
- (4) John O'Sullivan and Edward F. Keuchal, American Economic History: From Abundance to Constraint, (Watts, 1981), pp. 198-199.
- (5) Historical Statistics, Part 2, Series, N 156.
- (6) John O'Sullivan and Edward F. Keuchal, American Economic History: From Abundance to Constraint, (Watts, 1981), p. 199.
- (7) Charles H. Hession and Hyman Sardy, Ascent To Affluence: A History of American Economic Development, (Alynn and Bacon, 1969).
- (8) Richard B. Freeman, "The Evolution of American Labor Market, 1948-1980," in The American Economy In Transition, Martin Feldstein, ed., pp. 349-394.
- (9) ECONOMIC REPORT OF THE PRESIDENT, January 1957, (Government Printing Office, 1957), p. 106, Table D 7.
- (10) John O'Sullivan and Edward F. Keuchal, American Economic History: From Abundance to Constraint, (Watts, 1981), pp. 211-213.
- (11) Richard E. Caves, "The Structure of Industry," in The American Economy In Transition, Martin Feldstein, ed., pp. 501-544.
- (12) Robert J. Gordon, "Postwar Macroeconomics: The Evolution of Events and Ideas," in The American Economy In Transition, Martin Feldstein, ed., pp. 101-162.
- (13) Ibid.
- (14) Manuel Castells, The Economic Crisis and American Society, (Princeton University Press, 1980), pp. 200-202.
- (15) See Raymond W. Goldsmith, Financial Institutions, (Random House, 1968) for an analysis of post World War II financial institutions.
- (16) A very good summary of the 1930s financial market reforms is in "An Economic Brief Against Glass-Steagall," Thomas F. Huertas, Journal of Bank Research, Autumn 1984, pp. 148-159.
- (17) Mortgage Banking, Robert H. Pease and Lewis O. Kerwood, eds., (McGraw Hill, 1965) contains background on thrift industry regulation.

(18) See Raymond W. Goldsmith, Financial Institutions, (Random House, 1968) for an analysis of the asset/liability structure of financial institutions during the post war era.

(19) For example, in 1960 commercial banks were paying an average return of 2.56 percent on savings and time deposits, compared to the 3.86 percent paid by savings and loan associations.

(20) Although mutual savings banks were twice as large as savings and loan associations at the end of World War II, savings and loans were equal in size in 1954 and were twice as large by 1970. See Goldsmith, Ibid.

(21) Because consumer installment credit comprised a continuously growing share of total consumer credit outstanding, the following discussion focus on installment credit. See Historical Statistics, Part II, Series X 551-560.

(22) Other things equal, a lengthening of maturity reduces the amount of repayments to be made during a given period of time; with debt thereby staying on the books longer, the stock of debt becomes larger than it otherwise would have been. Moreover, because smaller monthly payments lighten the current debt burden on household budgets, demand for loans tends to rise when maturities lengthen rapidly

(23) Federal Reserve Bulletin, June 1970.

(24) The following analysis is based on Annual Federal Credit Union Reports, from 1946 to 1970.

(25) Bureau of Federal Credit Unions, Federal Security Agency, Social Security Administration, FEDERAL CREDIT UNIONS: REPORT OF OPERATIONS FOR THE YEAR 1950, p. 2.

(26) U.S. Dept of Health, Education & Welfare, Social Security Administration, Bureau of Federal Credit Unions, FEDERAL CREDIT UNIONS: 1956 REPORT OF OPERATIONS, pp. 10-11.

(27) U.S. Dept of Health, Education, & Welfare, Social Security Administration, Bureau of Federal Credit Unions, FEDERAL CREDIT UNION PROGRAM: ANNUAL REPORT 1964, pp. 12-13.

(28) U.S. Dept of Health, Education, & Welfare, Social Security Administration, Bureau of Federal Credit Unions, FEDERAL CREDIT UNION PROGRAM: ANNUAL REPORT 1965, pp. 13-14.

CHAPTER SIX

The Current Economic State of Credit Unions

By 1970, the basis of postwar economic growth was seriously shaken. The traditional economic growth sectors, i.e., heavy industry, which provided for more or less sustained American prosperity throughout the postwar period, were declining in importance relative to the service sector. Further, the impact of foreign competition, using modern and efficient methods of production, were forcing American manufacturers into increasing competition in the latter's traditional postwar markets. The post World War II growth industries, such as steel and automobiles, were rapidly becoming economic cripples.

The situation worsened by 1980. Many industries, such as the steel and automobile industry, were looking to the federal government to impose trade barriers to protect domestic markets from the onslaught of foreign competition. Indeed, by 1980, the force of international competition culminated in a series of devastating closings of old industrial plants in the traditional production centers throughout the Midwest and East. The rapidly changing industrial conditions caused the rate of unemployment to reach new postwar heights. Moreover, as GNP growth slowed to an alarmingly low pace, the force of rising inflation sent the economy into a serious economic recession. Nominal interest rates reached double-digit levels causing financial markets to fall into a period of chaotic disarray.

Credit unions were impacted from both the nonfinancial and financial sectors of the economy. Credit unions were negatively impacted as they were tied to traditional industrial sectors, especially manufacturing, which

put them directly in the path of the economic recession of the early 1980s. Indeed, as the majority of credit unions were linked to occupational common bonds, particularly those attached to sagging industries such as steel, lumber, autos, and heavy equipment, many were forced either into liquidation or into mergers with other, economically viable credit unions. The concept of credit unions as a natural appendage to the industrial system and to the working class was dramatically affected. Moreover, as other financial institutions made inroads into traditional credit union markets, credit unions were unable to afford the luxury of operating as if they faced no serious competition. Consequently, credit unions were forced into a series of operational adjustments which changed them fundamentally from the institutions they were during the postwar era.

The Economy

A description of the economy during the 1970s reads like a laundry list of worsening problems: Real GNP growth fell drastically, inflation rates increased persistently, productivity growth slowed, and the 1980s opened with an extremely sharp recession. The problems of the 1950s--slow GNP growth, inflation, and unemployment--reemerged in a more extreme form.

(1)

Over the period from 1970 to 1984, gross national product valued in 1972 prices, increased at an average annual rate of 3.2 percent, as compared to 5.2 percent during 1960-69, and 2.4 percent over the years from 1953 until 1959. With the exception of the early 1980s, the economy

sustained real economic growth in excess of that of the mid to late-1950s but much lower than the rate of the 1960s. (2)

The rate of unemployment continually increased during the 1970s and climbed sharply during the early 1980s. The decade of the 1970s opened with a sharp recession during which the unemployment rate rose from 3.5 percent of the civilian labor force in 1969 to 5.9 percent in 1971. By 1973, the rate of unemployment fell to 4.9 percent and with the onset of another recession in 1975 the rate of unemployment rose to 8.5 percent. The unemployment rate stood at 6.1 percent of the labor force by year-end 1978. During the depressed economic conditions of the early 1980s, the unemployment rate rose to a postwar high of 9.6 percent in 1982 and 1983. During the entire period stretching from 1945 until 1970, the rate of unemployment had ranged from a low of 2.9 percent in 1953 to a high of 6.7 percent in 1961. Therefore, when compared with the postwar experience prior to that time, the 1970s and 1980s experienced a worsening employment problem. (3)

The problem of price stability also changed qualitatively. The consumer price index rose nearly 63 percent between 1950 and 1970, from a level of 71.4 in the former year to 116.3 in the latter year. By contrast, consumer prices soared over 155 percent between 1970 and 1984. The rate of inflation, as measured by both the consumer price index and the GNP deflator, increased sharply during the mid-1970s and also during the late 1970s. As a consequence of the sharp increases in food and energy prices, consumer prices rose sharply in 1973 and in 1974. Producer prices also rose sharply from 1973 to 1975, as the producer price index increased from

3.1 in 1972 to a peak of 15.3 in 1974. The inflation rate subsided until 1977 and then began to accelerate once again. In 1980, the consumer and producer price indices each increased 13.5 percent. Thereafter, the rate of inflation, as measured by these two indices, declined sharply. (4)

As can be seen in Table 6.1, compared to previous decades, the 1970s and early 1980s were besieged with relatively low GNP growth and relatively high rates of inflation. Unemployment also reached relatively high levels. Moreover, nominal interest-rates rose to unprecedented postwar heights.

Table 6.1
Selected Economic Indicators,
1970-1984

Year	Percent change:			UR	Yield on:	
	GNP	CPI	PPI		3-Month T-Bills	US Govt Bonds
1970	-0.3%	5.9%	4.9%	5.9%	6.45%	6.58%
1974	0.5%	11.0%	15.3%	5.6%	7.87%	6.98%
1975	-3.9%	9.1%	10.8%	8.5%	5.84%	6.98%
1976	6.7%	5.8%	4.4%	7.7%	4.99%	6.78%
1977	4.4%	6.5%	6.5%	7.1%	5.27%	7.06%
1978	4.4%	7.7%	7.8%	6.1%	7.22%	7.89%
1979	5.2%	11.3%	1.1%	5.8%	10.04%	8.74%
1980	1.6%	13.5%	13.5%	7.1%	11.51%	10.81%
1981	1.1%	10.4%	9.2%	7.6%	14.08%	12.87%
1982	-2.0%	6.1%	4.0%	9.7%	10.67%	12.23%
1983	0.5%	3.2%	1.6%	9.6%	8.69%	10.84%
1984	8.0%	4.3%	2.1%	7.5%	9.65%	12.44%

Source: Bureau of Economic Analysis, U.S. Department of Commerce, Business Statistics 1984: A Supplement to the Survey of Current Business, (U.S. Government Printing Office, 1985).

Notes: The first three columns give annual percentage rates of change; the last three columns give average yearly yields.

Key:

GNP = GNP, valued in 1972 prices
CPI = Consumer Price Index, all goods.
PPI = Producer Price Index, finished goods.
UR = Unemployment as a percent of the civilian labor force.
T-Bills = Yield on 3-month U.S. Treasury securities
U.S. Govt Bonds = Yield on 10-year U.S. Government bonds.

Inflation stemmed from the combined influences of slow productivity growth, sharply rising oil prices, and a rapidly expanding money supply. The money supply (measured as M1) tripled between 1960 and 1980, growing from \$127 billion in the former year to \$438 billion in the latter year. Sharp increases in petroleum prices contributed to inflation as well. As petroleum prices rose, however, significant adjustments were taken to conserve energy: higher mileage per gallon automobiles became popular, better techniques for heating and cooling were devised, and some conversion to natural gas and coal occurred in electrical generation. (5)

A more disturbing factor that contributed to the inflationary spiral came from the supply side. The growth rate of output per man-hour (a measure of productivity), which began to decline in the late 1960s, plummeted. From 1960 until 1970, output per man-hour in the private sector grew at an average annual growth of 3.2 percent. Growth in output per man-hour slowed to an average annual rate of 1.9 percent between 1970 and 1975. In 1979, 1980, and 1982, output per man-hour fell, so that between 1975 and 1982, output per man-hour grew at an average growth rate of 1.4 percent per year. (6)

Rising inflation contributed to sharply rising interest rates, particularly in the late 1970s. Nominal interest rates increased sharply whereas real (or inflation adjusted) interest rates rose relatively little. Holders of long-term bonds were particularly hard-hit as inflation eroded the purchasing power of annual interest payments and rising interest rates reduced the value of their holdings.

The decade of the 1980s began with extremely depressed conditions. GNP, in 1972 dollars, increased at an anemic rate of 1.6 percent in 1980, and continued at 1.1 percent rate in 1981, and only 2 percent in 1982. While the economy began to improve in 1983, real GNP increased by less than one percent in that year. Between 1980 and 1983, real GNP increased a meager .3 percent. Unemployment rose sharply in 1982, peaking at nearly ten percent of the civilian labor force. The unemployment rate fell thereafter. Nevertheless, in 1984, a year during which real GNP surged to a rate of 8 percent, the unemployment rate was greater than 7 percent. This recession did, however, reduce the rate of inflation markedly. During the brisk recovery in 1984, the consumer and producer price indices rose only 4 percent and 2 percent, respectively.

Both long and short-term nominal interest rates displayed extreme volatility during the early 1980s. Interest on 3-month treasury bills fluctuated between 15.49 percent and 7.07 percent in 1980. In the same year, the return on 30-year U.S. Treasury securities fluctuated between 12.40 percent and 9.81 percent. In 1981, interest rates on 3-month treasury bills fluctuated within a 6 percentage point range and averaged 10.6 percent for the year. Over the course of the same year, the return on 30-year U.S. government securities fluctuated within a 2.5 percentage point range and averaged roughly 13.44 percent. During 1982 and 1983, nominal interest rates displayed less volatility as well as a tendency to fall. During 1983, returns on 3-month Treasury bills and on 30-year Treasury securities averaged 8.58 and 11.18 percent, respectively. (7)

The economic recovery continued into 1984 and 1985. In the former year, real GNP increased roughly 6 percent, whereas in the latter year, GNP growth slowed to roughly 2.9 percent. Real GNP rose 3.8 percent in the first quarter of 1986, but then rose only 1 percent during the second quarter. (8) Table 6.2 displays the growth, valued in 1972 dollars, in the components of GNP during the period from 1980 to 1984. Strong growth in gross domestic investment and in consumer expenditures, particularly on durable goods, led to an expansion in aggregate demand. The effect of growth in domestic demand, however, failed to elicit continued strong growth in gross national product. As imports rapidly outdistanced exports, domestic demand shifted to the purchase of foreign made products.

Table 6.2

Percent Change in GNP Components,
Valued in 1972 Prices

Item	1980-82	1982-84
Gross Domestic Fixed Inv.	-3.9%	29.5%
Personal Consumption	3.4%	10.3%
Durable Goods	2.2%	26.7%
Government Purchases	3.0%	6.7%
Net Exports	-41.0%	-198.0%

Source: Bureau of Economic Analysis, U.S. Department of Commerce; Business Statistics 1984: A Supplement to the Survey of Current Business, (U.S. Govt. Printing Office, 1985).

Relatively high interest rates in the United States in the 1980s shifted the international demand for dollar-denominated assets upward. After depreciating in value against major currencies during the 1970s, the dollar has continued to appreciate since 1980. The dollar's value in

foreign markets thus increased the price of U.S. goods to potential buyers and lowered the dollar price of imports in the United States. Exports, valued in 1972 dollars, fell from \$160 billion in 1981 to \$146 billion in 1984, whereas the value of imports in 1972 dollars rose from \$116.4 billion in 1981 to \$161.1 billion in 1984. The depreciation of the dollar beginning in 1985, however, failed to improve net exports in 1985 or in 1986. From the onset of the depreciation of the dollar through the second quarter of 1986, real net exports fell \$67.6 billion. (9)

The rate of unemployment stabilized at roughly 7 percent of the labor force during the period from 1983 until 1985. Moderate inflation continued to accompany real GNP growth. The GNP deflator, the broadest general price index, increased roughly 4 percent during 1985. The index of prices of finished producer goods rose 2 percent during the same year, while the consumer price index increased roughly 4 percent. In 1986, second quarter, the GNP implicit price deflator rose at an annual rate of 3 percent. By 1985, interest rates were lower and more stable than they had been during the entire 1980s. Short-term and long-term interest rates fell again in 1985. By December 1985, the 3-month treasury bill rate stood at 7.50 percent; the interest rate on 30-Year U.S. Treasury securities dropped to 10.9 percent from 12.39 percent in 1984. (10)

National Income

For the period under review, nominal national income increased from \$814.8 billion in 1970 to \$1,267.4 billion in 1975, a 55 percent increase. It then jumped to \$2,174 billion in 1980, a 71.5 percent increase over

1975. Slowing inflation and depressed economic activity, however, reduced the rate of nominal national income growth. By 1983, national income reached \$2,651.9 billion, a mere 22 percent increase over 1980.

In real terms, the manufacturing sector performed poorly over this period. National income generated in that sector rose 148 percent in nominal terms between 1970 and 1980, while the producer price index for manufactured goods rose 137 percent over the same ten years. Hence, real national income generated in manufacturing increased a meager 11 percent from 1970 until 1980. Between 1980 and 1982, national income generated in this sector increased 4.4 percent, whereas the producer prices of manufactured products rose 12 percent. Therefore, real national income generated in the manufacturing sector fell over 7 percent during the early 1980s. Accordingly, the proportion of national income generated in manufacturing fell sharply during the 1970s and early 1980s. Whereas, in 1965, 30 percent of national income was generated by activity in the manufacturing sector, by 1983, that sector accounted for only 21.9 percent of the total of national income.

Table 6.3

Percent Distribution of National Income,
by Sector, 1970-1983

Sector	1970	1975	1983
Agric/Forest/Fish	3.1%	3.5%	2.3%
Mining	1.0%	1.5%	1.5%
Construction	5.5%	4.9%	4.2%
Manufacturing	26.4%	25.1%	21.9%
Wholesale/Retail Trade	15.2%	15.4%	14.6%
Fin/Insurance/Real Est	11.7%	11.5%	14.9%
Transportation	3.8%	3.6%	3.3%
Comm/Public Utilities	4.0%	4.1%	4.7%
Services	12.8%	13.3%	16.1%
Government	15.8%	15.9%	14.8%

Source: Bureau of the Census, U.S. Department of Commerce, Statistical Abstract of the United States 1985, (U.S. Government Printing Office, 1985), p 437.

As secular trends continued to assert themselves, the share of national income produced in agriculture, forestry, and fisheries continued to decline sharply. In 1983, these sectors generated 2.3 percent of national income as opposed to 4.4 percent in 1956. The share of national income generated in transportation also continued to decline. In 1956, the transportation sector accounted for 5.8 percent of national income; by 1983, its share fell to 3.3 percent. The services sector continued to claim an increasing share of national income as evidenced by the fact that activity in this sector generated 16 percent of national income in 1983 as opposed to an average of roughly 9 percent during the 1950s.

Two sectors that claimed a relatively stable proportion of national income were mining, whose income share fluctuated between 1 and 1.5 percent and the communications/public utilities sector, whose income shares fluctuated between 3.9 to 4.7 percent.

Employment

The number of employees on nonagricultural payrolls increased 27.6 percent between 1970 and 1980. During the 1980-82 recession, employment in nonagricultural establishments fell 1 percent.

As shown in Table 6.4, the sectoral distribution of employment closely reflected the distribution of national income previously discussed. Manufacturing, whose income share declined over the period from 1970 until 1983, accounted for a diminishing percentage of nonagricultural employees. Employment in that sector increased a meager 4.7 percent from 1970 until 1980. During the years from 1980 until 1983, employment in manufacturing fell almost 9 percent. In 1983, manufacturing generated 20.5 percent of nonagricultural jobs as opposed to 31 percent in 1960 and 35 percent in 1945.

As will be discussed below, this shift in the relative importance of the manufacturing sector created severe economic hardships for the occupational based Federal Credit Unions during 1979 to 1982. The economic stagnation that hit manufacturing forced a record number of FCU liquidations and mergers. In response, the NCUA was forced to permit credit

unions to broaden their membership base through charter expansions into multi-group membership fields. (11)

Table 6.4

Percent Distribution of Employees on
Nonagricultural Payroll, by Sector:
1970, 1975, 1983

Sector	1970	1975	1983
Mining	0.9%	1.0%	1.1%
Construction	4.7%	4.6%	4.4%
Manufacturing	27.4%	23.8%	20.5%
Wholesale/Retail	21.1%	22.2%	23.1%
Fin/Ins/Real Est	5.2%	5.4%	6.1%
Trans/Comm/Publ Util	6.4%	5.9%	5.5%
Services	16.5%	18.1%	21.8%
Government	17.8%	19.1%	17.6%

Source: Bureau of Labor Statistics, U.S. Dept. of Labor, Employment, Hours, and Earnings, United States, 1909-84,

Employment gains were strongest in the mining sector and the services sector. Between 1970 and 1980, employment increased 65 percent in mining and 54 percent in services. During the 1980-82 recession, however, employment in mining fell nearly 7 percent whereas service sector employment increased 10 percent. Over the entire 13 year period, the mining sector accounted for approximately 1 percent of total employment. The service sector absorbed a steadily rising proportion of nonagricultural employees. The service sector share of employment rose from 15 percent in 1970 to 21.8 percent in 1983.

The next strongest area of employment growth occurred in the finance/insurance/real estate sector. During the decade of the 1970s, the number of employees in this sector increased 40 percent. In spite of the severe recession during the early 1980s, employment in this sector grew 6 percent. Hence the finance/insurance/real estate share of employment continued its postwar rise: 6.1 percent in 1983; 5 percent in 1960; 4 percent in 1947.

Employment in the public sector increased 29 percent during the 1970s. Public sector employment at all governmental levels, however, fell during the early 1980s. Between 1980 and 1982, public sector employment fell 2.4 percent, a decline shared equally at the federal, state, and local levels. Hence, the share of employment generated by the public sector drifted downward during the late 1970s-early 1980s.

Earnings

As indicated in earlier chapters, American workers generally enjoyed rising real earnings throughout the postwar period. Table 6.5 corroborates that conclusion. Measured in 1977 dollars, average hourly earnings steadily increased in the private sector, rising from \$3.07 in 1953 to \$4.27 in 1970. Real hourly labor compensation rose most rapidly during the 1960s, as indicated in Table 6.5. During the mid-1970's, and again in the late 1970s-early 1980s, the combined effects of rising inflation rates and deteriorating economic conditions led to a decline in real hourly earnings. From \$5.38 in 1973, real hourly earnings in the private sector fell to \$5.10 in 1975. Real hourly wages rose .8 percent between 1975 and 1979

before falling once again during the depressed conditions which prevailed during the period from 1979 to 1982. By 1982, the average hourly rate of compensation fell to a low of \$4.83 per hour.

Table 6.5

Percent Change in Average Hourly Compensation,
by Sector in 1977 dollars

Sector	60-70	70-75	75-80	80-83
Nonagricultural	18.0%	1.2%	0.8%	0.2%
Mining	13.0%	11.5%	0.6%	2.1%
Construction	30.1%	0.7%	-11.3%	-0.3%
Manufacturing	13.2%	4.0%	-1.8%	0.9%
Wholesale/Retail	21.1%	-0.9%	-4.1%	-1.2%
Fin/Ins/Real Est	16.0%	-4.6%	-7.0%	4.7%
Transportation	n.a.	10.2%	-1.5%	1.2%
Services	n.a.	3.4%	-5.1%	2.6%

Source: U.S. Dept. of Labor, Bureau of Labor Statistics, Employment, Hours, and Earnings, United States, 1909-1984, March, 1985.

The Changing Structure Of Financial Markets

The intermittent periods of disintermediation during the mid to late 1960s and the growing consumer demand for alternative savings deposit instruments led to many new consumer financial products and services. Initially, these were introduced by nontraditional financial institutions, such as brokerage firms and retailers such as Sears. These innovations increasingly infringed on the traditional consumer financial markets of depository institutions. To compete, depositories attempted to elude regulatory constraints. As inflation soared during the 1970s and interest

rates climbed and became binding, the opportunity cost of holding idle funds sharply increased. To prevent disintermediation from reaching dramatic proportions, regulatory authorities permitted a series of competitive responses by financial depositories.

As competition intensified, financial market regulations were continually revised and adjusted. With the passage of the Depository Institutions Deregulation and Monetary Control Act of 1980 and the Garn-St. Germain Act of 1982, financial markets were for the most part deregulated. These Acts eliminated many barriers to financial market competition, thereby allowing the market mechanism to establish deposit and loan rates, product and service offerings, and to increase the competitive awareness/decision-making process of financial depositories. (12)

Deregulation

The periods of disintermediation which occurred during the 1960s and into the 1970s led to the conclusion that the regulatory regime constructed during the 1930s had become increasingly constraining and out of touch with the financial environment which evolved by the 1970s. Several events occurred during the early years of the 1970s which, in hindsight, were the first steps toward a comprehensive deregulation of financial markets.

First, due to pressure of disintermediation, Regulation Q ceilings were lifted for Certificates of Deposit over \$100,000. Second, responding to reoccurring financial sector conflagrations, the federal government commissioned several studies to examine various aspects of financial

market reform. These studies, (e.g., the Report of the Hunt Commission 1970), recommended that ceilings on time deposits be phased out over a five-year period and that depository institutions be granted broader powers. The principal theme of the commission's report was that a deregulated financial system would operate more efficiently than the highly regulated arrangement which existed. (13) Third, in 1972, Negotiable Orders of Withdrawals (NOW accounts) were introduced in New England states as thrifts attempted to compete more effectively for consumer funds. Finally, as market interest rates periodically rose to Regulation Q ceilings, nonbank financial firms began to offer a growing array of financial products/services. The appearance of these varied product offerings was an important factor which intensified financial market competition. (14)

A key innovation during the 1970s was the Money Market Mutual Fund (MMMF). This investment instrument originated as an attempt to offer small savers a market rate of interest at a time when the only rates available at depository institutions were subject to Regulation Q. The MMMFs represented pools of liquid assets managed by investment companies which would, in turn, sell small denomination shares in those funds to the public. While the funds were not insured, they were generally secured by high quality liquid assets, such as Treasury bills and were not subject to interest rate ceilings or regular reserving requirements. Many MMMFs offered attractive services to the small saver, the most significant was the ability to write checks against the value of the account. (15)

Consumer acceptance of MMMFs generated an intense disintermediation problem for financial depositories. Consumers invested growing amounts of their financial assets into these funds. In 1978, regulatory authorities responded by approving the issuance of the Money Market Certificate, MMC. The MMC allowed weekly adjusted treasury-bill linked rates to be paid on certificates of 6 months maturity. These certificates significantly reduced a depository institution's exposure to disintermediation. Thrifts, however, did not directly benefit, as the 6 month provision attached to the certificate encouraged depositors to place funds in relatively short-term accounts, which did nothing to help thrifts overcome the imbalance between the term structures of their assets and liabilities. Consequently, in 1979, permission was granted for a Small Savers Certificate (SSC) of 4-year maturity and later of 2 1/2 year maturity to be offered to depositors. There was no (regulatory) minimum denomination required, and the ceiling limit of SSC was indexed to the 30 month treasury bill which was to be adjusted monthly. (16)

While the new deposit accounts did assist in slowing the outflow of funds from banks and thrifts, it had become evident to regulatory authorities that "stop-gap" deregulatory measures and adjustments to Regulation Q ceilings were not succeeding. Significant steps were therefore needed to fully deregulate depository institutions. The following lists summarizes those events (which are in no way independent of each other) which eventually led to financial industry deregulation: (17)

- The Interest Rate Problem. Interest rate levels and volatility during the 1970s and early 1980s had reached

unprecedented highs. Such a situation placed tremendous pressure on the earnings of depositories, especially thrift institutions.

- The Thrift Problem. Thrifts experienced considerable difficulty from 1979 to 1982 due to high interest rates which threatened to upset the delicate margin between their fixed rate, long-term assets and their short-term, interest-sensitive liabilities. (18)
- The Regulation Q Problem. As short-term interest rates rose above Regulation Q ceiling rates, depositories suffered extensive disintermediation. The run-off of funds became particularly acute with the introduction and widespread consumer acceptance of MMMFs, which led regulatory authorities to the conclusion that only a comprehensive deregulation of deposit ceiling rates would yield a competitive solution to the problem of disintermediation.
- The Competitive Problem. Given the fact that financial market pressures were forcing depositories to act increasingly alike, it became apparent that there was no reason that financial institutions should operate under different sets of rules and regulations. For example, although banks and credit unions offered the generally same consumer products/services, these institutions operated under different sets of regulatory constraints which, for

the most part, provided credit unions with a competitive advantage. (19)

- Technological Change. Rapid innovations in electric funds transfer and automatic teller machines, among other electronic developments, made the traditional boundaries between financial institutions obsolete. Technological advances also permitted nondepositories to offer an array of consumer financial instruments which could be readily substituted for the traditional products offered by depositories. (20)
- The Growth of Nondepository Institutions. Traditional financial market relationships had eroded with the entry of nondepository financial firms into the traditional markets of the financial depositories. Some of these new firms were financial in nature, such as Merrill-Lynch, while others were previously nonfinancial in nature, such as Sears. (21)
- More Sophisticated Customers. Related to the aforementioned factors was an enhanced level of consumer sophistication. Many consumers, having experienced years of high inflation and volatile interest rates, along with eroding real wages, became much more adept at managing their funds.

These factors led to increasing competition between consumer financial service providers. Because of financial market regulations, depository

institutions found it extremely difficult to compete on a equal footing with their nonbank counterparts. Thus, faced with the choice of regulating the nondepository institutions or deregulating the depository institutions, Congress elected to deregulate the traditional depository institutions. The culmination of their efforts was the passage of the Depository Institutions Deregulation and Monetary Control Act (DIDMC) in March 1980. (22)

This watershed legislation was comprised of a large number of diverse provisions, but for concerns directly at hand, the critical issues were:

- All interest rate ceilings on time deposits were to be phased out over a six year period.
- NOW accounts became authorized for banks and thrifts nationwide, (to be offered to consumers not to corporations).
- Mortgage rate caps were eliminated unless state governments passed laws reinstating such ceilings.
- Asset composition of thrift institutions were eased, permitting up to 20 percent investment in consumer loans.
- All depositories were given access to the Federal Reserve's discount window, but they were also subjected to Fed Reserve Requirements.

The fundamental tenant which formed the basis of the 1930s regulation of banking, namely that price competition in banking was unsound, was reversed by this landmark legislation. DIDMC essentially stated that without price competition the financial system would languish in inefficiencies.

Although the DIDMC provided a partial solution to the thrift problem, by 1982 many thrifts that were financially distressed in 1980 were bankrupt. Compounding this was an accelerating pace of technological change in financial service delivery and more intense competition, especially from nonbank financial institutions. The net effect of these developments resulted in a second piece of legislation, the Garn-St. Germain Depository Institutions Act, which was passed in 1982. (23)

As with the DIDMC, the Garn-St. Germain Act authorized financial depository institutions to offer deposit accounts which had characteristics similar to those of MMMFs. In accordance with the Act, banks and thrifts began offering money market deposit accounts (MMDAs) by December 1982, and Super NOW accounts by January 1983. Neither of these accounts were subject to extant interest rate ceilings and the rates paid reflected market rates of interest. The MMDA is a savings (deposit) account with a minimum deposit requirement of \$2,500 which allowed a limited number of third party transfers. The Super Now account is a transaction account subject to a 12 percent Regulation D reserve requirement which allowed unlimited checking. Both accounts are liquid in the sense that they were available on demand.

The introduction of these accounts permitted banks and thrifts to bolster their competitive posture vis-a-vis other consumer financial service providers. The Act also broadened thrift powers, authorizing savings and loan associations to make business loans and to accept business deposits. Thrifts were also permitted to increase business loans up to 10

percent of their assets. Consumer loans made by thrift institutions were also increased from 20 percent to 30 percent of assets.

These regulatory changes induced major structural adjustments by financial institutions which resulted in a heightened level of financial market competition. Small savers were granted greater equality as market rates were now being paid on savings deposit accounts of any denomination. The need to support a continuous, stable turnover of assets had also prompted a higher and more efficient level of financial institution management. Finally, market stability had grown more pronounced as the disintermediation process was reduced to a moderate level.

The reforms of the 1930s and 1980s stand out as major structural changes in the U.S. financial system. Whereas both reform periods were induced by a crisis atmosphere, the more recent crisis was not as severe as the depression of the 1930s. The 1930 reforms were constructed in manner to limit the extent of financial market competition and to erect regulations which became the basic structural outline governing financial markets and institutions over the postwar period. In contrast, the reforms of the 1980s were designed to promote financial market competition and to dismantle a number of constraints restricting financial market efficiency. Thus, the recent financial market deregulation represents a significant step toward competitive solutions with respect to operational principles, product and service offerings, and prices charged by financial depositories.

Consumer Deposit Accounts

As discussed, a number of important changes have occurred in the liability structure of financial depositories. Consumer demand, spurred by an increasing opportunity cost of holding idle funds, unleashed an onslaught of alternative consumer investment instruments in the form of deposit accounts. Time deposits at commercial banks, for example, became the main source of deposit growth from 1979 to 1982. Most of the growth in time deposits came from the proliferation of small time deposits, which increased in both amount and number. The small time deposit account shifted from the least important source of funds at the end of 1978 to the most important source at the end of 1982. These types of accounts also grew nearly twice as fast as any other deposit category.

In the area of competitive deposit offerings, banks and thrifts as well as credit unions (discussed in the following chapter) are now competing on a equal basis with the nontraditional financial institutions. Indeed, with the introduction of the MMDA, funds placed in MMMFs declined. There are several reasons generally cited for this change: MMDAs are covered by deposit insurance while MMMFs are not; MMDAs pay market rates as do MMMFs; MMDAs allow consumers to maintain an account which directly competes with MMMFs while at the same time realizing the convenience of one-stop banking. (24)

Essentially, deregulation allowed depositories to price their deposits according to prevailing market conditions and to effectively differentiate their products and services. The following briefly

summarizes the relative position of depositories in the consumer savings market from 1970 to 1985.

From 1970 to 1975, consumer savings at commercial banks increased 9.9 percent, 5.3 percent in demand deposits and 14.1 percent in time and savings deposits. Savings and loans increased 14.3 percent, while mutual savings banks increased 8.9 percent. Credit union member savings increased 16.3 percent. With respect to the distribution of total savings, banks held 43.8 percent of consumer savings in 1975; savings and loans held 37.9 percent, while mutual savings banks held 13.9; credit unions held only 4.3 percent. (25)

Consumer savings increased 8.9 percent from 1975 to 1980 at commercial banks, 6.2 percent growth in demand deposits and 10.6 percent growth in time and savings deposits. Deposit accounts at savings and loan associations and mutual savings banks increased 12.3 and 6.9 percent, respectively. Member savings at credit unions increased 14.3 percent over this same period. The share of consumer savings held by banks experienced a relative decline in the 1976-1979 period but reversed by 1980 when it stood at 44.1 percent. The savings and loan associations' share of the consumer savings market increased throughout and peaked in 1979 at 39.9 percent. Mutual savings banks continued to experience declining shares, as their significance fell to 11.8 percent by 1980. Credit unions remained relatively small with only 4.9 percent of the consumer savings market. By year-end 1984, commercial banks held 45.9 percent of total consumer savings. Savings and loans and mutual savings banks held 9 percent and 5.2

percent, respectively. The share held by credit unions rose to 5.2 percent.
(26)

Consumer Credit

As discussed in the previous chapter, consumer credit grew slowly until the mid-1970s, at which time it began growing buoyantly again. This increase was dominated by growth in consumer installment credit, which comprised well over 75 percent of total consumer credit outstanding throughout the entire decade and stood at 80 percent by 1980.

Consumer installment credit reached rates of growth of 19.2 percent in 1977, 18.7 percent in 1978, and 14.3 percent in 1979. However, by 1980 growth slowed considerably, falling to .6 percent in 1980, 6 percent in 1981, and 6 percent in 1982. This decline in consumer installment credit reflected the general economic conditions which prevailed during that time. The curtailment of credit was especially acute in automobile lending, as automobile credit increased only .3 percent in 1980.

In 1980, commercial banks and credit unions both realized reductions of over 5 percent in their shares of consumer installment credit outstanding. Finance companies, on the other hand, increased their share of outstanding consumer installment credit, as they realized a 12.4 percent growth. Consequently, the share of installment credit held by banks fell to 46.5 percent from 49.4 in 1979, and the share held by credit unions fell from 16.4 percent to 14 percent in 1979. The share held by finance companies grew from 24.1 percent in 1979 to 27 percent in 1980. (27)

While the reduction of consumer demand played a large part in the slowdown of consumer installment credit, supply constraints may have played an even more significant role. (28) Loan ceilings began to broadly restrict lending by 1979. As a result, many states were forced to adjust their interest rate control laws over the next three years. The effect on credit unions was manifested in the restructuring of their asset portfolio. As will be seen below, after 1979, FCUs shifted assets into investments and out of member loans. The subsequent lifting of loan rate limits permitted credit unions to adjust their loan interest rates to more accurately reflect the prevailing supply and demand conditions in the market and in accordance with their cost of funds. As a result, loans outstanding at credit unions began to increase in 1983.

By 1983, consumer credit growth rebounded, rising at a 12.7 percent annual rate. Savings and loan associations realized the most rapid growth, increasing 33.7 percent; at mutual savings banks installment credit increased 21.2 percent. However, in 1983 these institutions held only 5.5 percent and 1.6 percent, respectively, of total consumer installment credit. Commercial banks increased their installment lending 17 percent, while installment loans at credit unions grew 13.2 percent in 1983. The share of installment credit held by commercial banks and credit unions in 1983 were 43.4 and 13.7 percent, respectively.

In 1984, consumer installment credit held by banks grew 23.5 percent; while credit unions installment lending increased by 26.1 percent. Savings and loan associations and mutual savings banks grew by 47.6 and 36.3 percent, respectively. In terms of the share of total outstanding consumer

installment credit, in 1984 commercial banks held 44.2 percent, up from 43.1 percent in 1983. Credit unions held 14.9 percent which is also up from 14.2 percent held in 1983. Savings and loans and mutual savings banks both increased their shares as well, the former reaching 6.6 percent, while the latter reached 1.7 percent. The shares held by finance companies and retailers fell, as the growth in installment credit issued by these two lenders was below that of depository institutions.

The Transformation Of Federal Credit Unions

By 1970, the traditional credit union industry was rapidly changing, as it faced increasing levels of competition from other financial institutions. Commercial banks competed aggressively in the consumer lending market, especially in the area of automobile loans. All purpose credit cards were growing increasingly popular and retail stores were providing more revolving credit. Competition for member savings also increased as nondepository financial institutions offered an array of substitute savings instruments which paid market rates of interest. This competition became more intense as the 1970s evolved.

Coupled with the heightened levels of competition was an increasing use of electronic data processing, not only as a means to reduce the bookkeeping costs, but as a means of electronic funds transfer (EFT). Thus, the traditional credit union advantage of payroll deduction for member's savings was threatened: consumers could now deposit their entire paycheck and divide the funds among their various accounts electronically. The automatic teller machine made its debut, providing consumers with

twenty-four-hour deposit and withdrawal capabilities from remote locations. (29)

After an unsuccessful attempt to establish credit unions among the poor during the mid to late 1960s, it became clear that lower income groups, especially the very poor, were not the membership base that could support credit union growth. Not only were the poor without adequate savings, but they were significant "credit risks". This attitude differed dramatically from the philosophical origins of their past, as credit unions rarely evaluated members according to the extent that the latter were credit risks. Indeed, such attitudes would have chagrined Bergengren and other leaders, who continually stressed that the purpose of credit unions was to assist the small income earner to overcome the burdens of financial distress. Nevertheless, significant change occurred in that credit unions, especially the very large ones, were developing a clear orientation toward the more affluent members of the working class. (30)

The fact that members were growing increasingly affluent and becoming more financially adept in financial market dealings relative to the past served to reinforce an industry attitude that credit unions were catering to characteristics of their membership bases. As a result, the aim of credit union management turned increasingly toward growth and stability of the credit union as an institution as opposed to meeting the needs of the membership. (31)

By the late 1970s, credit unions were hit by the dual impact of financial market changes and the economic dislocation which occurred

throughout the nonfinancial sectors. While other financial depositories were also affected during this period, credit unions were hit particularly hard in as much as their viability and growth depended directly on economic growth in the nonfinancial sectors and stability in financial markets. Whereas, on the financial market side, credit unions faced pressures similar to other depositories, they were literally shaken loose from their traditional foundation by events throughout the nonfinancial economy. (32)

As previously discussed, nonfinancial economic activity changed dramatically--unemployment increased, output per manhour declined, the share of traditional manufacturing industries in overall national income fell, and there occurred a structural shift in economic activity toward the service sectors. The traditional credit union sponsor relationship, which historically supported the credit union industry and provided a sound economic foundation on which to grow, turned abruptly into its detriment. The economic decline of traditional manufacturing forced many credit unions to cease operations or to merge with other credit unions. Between 1979 and 1982, more FCUs were forced into liquidation than at any other time in their history. Nevertheless, while liquidations reached unprecedented levels, the majority of troubled credit unions were merged into other credit unions. For example, in 1980, 239 credit unions were liquidated while 313 were merged into another credit union's operations. In 1981, 251 credit unions were liquidated and 333 were merged. During these two years, the National Credit Union Share Insurance Fund incurred the greatest amount of expenses ever in its history, thereby indicating the extent of the crisis faced by credit unions. (33)

In order to eliminate the dependence on a particular sponsor or industry, the NCUA deregulated FCU dependence on single sponsors. The NCUA alleviated FCUs from this constraint by relaxing its fields of membership chartering and expansion policies, which meant that FCUs could serve an increasingly diversified membership base. (This will be addressed more fully in the following chapter.) Essentially, this field of membership expansion allowed FCUs the wherewithal to offset a drop in membership as a result of layoffs or plant closings; to provide services to new groups; and to improve stability through a broadening of its economic base. As stated in the 1984 Federal Credit Union Report: (34)

"Instead of an inclusive concept allowing credit unions to bring in new people, field of membership became exclusively and rigidly defined. 'Family' meant one social pattern of people living under one roof. 'Occupation' meant working for a single company. 'Communities' were first defined as areas with 5,000 people, then 10,000, and so on. Instead of individuals getting together to form a cooperative to make available to people of small means credit for provident purposes, regulators were dictating who could get together....

The NCUA "deregulated field of membership chartering and expansion policies, beginning in 1982." This was not only in part due to the severe economic climate facing credit unions, but the NCUA "was returning to the credit union boards the right and responsibility to determine whom the credit union would serve."

"Before 1920, all credit unions had open charters, and fields of membership restrictions evolved as an element of convenience to those working to form a new credit union....never again will one single sponsor be economically feasible....The common bond of people joining together under a democratically controlled organization for the purpose of providing reasonable credit and a method of savings has not and never will change....The single sponsor common bond is not deeply rooted in credit union tradition, but it is an accident of history. Perhaps one day it will be viewed as an aberration in the evolution of the common bond."

As a result of the NCUA actions, "involuntary liquidations fell dramatically...down to 38 from 1983's 50 cases and a 1981 peak of 251."

The major changes which came as a result of the relaxation of the field of membership constraint were:

1. Credit unions were permitted to define a family member as any person related to a person who fell under a credit union's common bond.
2. Credit unions were permitted to serve employees of nearby firms or associational groups that requested credit unions service. (35)
3. Credit unions were permitted to take in any retiree as a member.

The NCUA also deregulated interest rate ceilings and product/service offerings. FCUs, were as a result, authorized to issue share drafts, to install automatic teller machines, to issue bank and other credit cards, and to plan for the provision of trust services. They were also permitted to borrow money through central loan facilities, to issue money market certificates, and to establish individual retirement accounts. These changes placed the credit union industry in direct competition with the giants of the consumer financial service industry. In addition, NCUA placed the responsibility of operation, deposit structure, loan policy, and pricing directly into the hands of FCU management. In so doing, the NCUA made survival a function of management's ability to react to market forces and to make "proper" decisions regarding products, pricing, and general competitive posture. FCUs have, as a result, been given the freedom to allocate their energies into product and service development in a manner which will best reach the credit union's objective with respect to growth and development. (36)

Thus, from a unique economic entity, living in the cracks of the economy, credit unions have manifested into an economic entity that could

no longer evade the competitive market forces that shaped economic life in United States.

Credit Union Management

As discussed previously, credit unions in the past were very simplistic financial institutions, as their assets were primarily member loans and their liabilities were primarily member savings. During these early years, nearly all credit unions were managed by volunteers. Since this was the case, credit union regulatory authorities forced upon credit unions a very rigid operating structure, which made credit union management simply a caretaker of member funds. Moreover, since credit unions faced virtually no competition, there was little need for credit union management to be sophisticated in its dealings with financial markets.

During the initial phases of FCU development, 1934-1945, the most pressing issue which faced credit union management was simply the collection from members of loans advanced. However, this never grew to serious proportions, as evidenced by the fact that historically credit unions never suffered from problems of loan delinquency.

John Croteau, considered by many to be the "Economist" of credit unions, characterized the development of credit union management as follows:

"The early credit unions, managed economically by volunteers, were "social-worker" oriented....The "social-worker" attitude was the early approach of the Russell Sage Foundation, a pioneer in consumer finance. Not until the late 1950s did a significant change take place in the character

of credit union management. Credit unions gradually became "business oriented" and openly moved to serve middle-income rather than lower-income groups." (37)

By the mid-1960s, credit union management placed increasing emphasis on attracting higher levels of member savings. Corresponding to and partially motivating this development was a new breed of credit union managers which had entered the industry. This new group differed from the former in so far as they were interested in growth for growth's sake. Whether members derived any direct benefit from a credit union's growth had thus grown relatively insignificant. This change in management attitude, however, was concentrated in the larger asset size credit unions. Indeed, it was these credit unions which, because of their size, first experienced the separation of the credit union as a financial institution from the early credit unions which were an appendage of the membership. (38)

As financial markets grew more competitive during the 1970s, credit unions were forced to enhance their management skills. Managing and directing a credit union was complicated by smaller spreads between interest-earning assets and interest-paying liabilities, more sophisticated members, and the need for better trained staffs. Whereas in the past, credit union management had very little in the way of technical skill, in the financial and economic environment of the 1980s, credit union management had to become familiar with: (39)

- Accounting and controllership
- Asset/liability management
- Data processing
- Personnel Management

- Marketing
- Diverse loan programs
- Operations
- Organizational planning and development
- Banking

The key question facing credit union management today is whether credit unions should become full service financial institutions or remain specialized in member loans and deposits. It is apparent that many credit unions have opted for the former, as members have made it quite clear that they will move their funds to the institution which offers them the "best" deal.

Thus, as credit unions have been drawn increasingly into financial market competition and in lieu of NCUA's shifting of operational responsibility onto the management of a credit union, there has been a shift towards a new dynamic approach to credit union management.

Numbers and Members

In 1970, the number of FCUs chartered peaked at an all-time high of 13,555; but by 1971 the number of FCUs dropped to 13,494 and by 1972 were down to 13,133. The falling number of FCUs trends continued throughout the decade and reached a low of 12,738 by year-end 1979. Thus, during the 1970s, the number of FCUs fell 6 percent, the greatest decline since World War II. This decline continued and quickened during the early part of the 1980s and by year-end 1985 the number of FCUs stood at 10,125.

The decline in the number of FCUs, however, varied among types. The number of associational FCUs declined from 2,131 at year-end 1970 to 1,968 by year-end 1979, a reduction of nearly 8 percent. The number of residential FCUs rose from 535 in 1970 to 541 in 1979, a negligible yet positive growth. Over this same period, the number of occupational based FCUs declined from 10,889 to 10,229, a decline of 6.1 percent. Over the next five years, the reduction in occupational based FCUs was tremendous, falling 21.9 percent and reaching a low of 7,990 by year-end 1985. Residential FCUs numbered 542, and associational FCUs dropped to 1,593, a reduction of 19.1 percent. (40)

From 1979 to 1985, the number of FCUs declined 20 percent as the widespread economic stagnation which reached serious proportions led to a record number of credit union liquidations and mergers. From 1980 to 1985, every occupational based FCU experienced a significant reduction in their numbers. The greatest decline was in the wholesale/retail group, as they fell 32.3 percent. Mining, manufacturing and construction based FCUs followed with reductions of 26.1, 25.8, and 23.1 percent, respectively. All others fell by less than 20 percent during this period.

The relative rate of decline in the number of FCUs also changed the distribution of FCU types. The share of the occupational based FCU declined to 78.9 percent of all FCUs by year-end 1985. The associational and residential types comprised 15.7 percent and 5.4 percent of the total number of FCUs.

Within the occupational grouping, the manufacturing segment declined in relative importance during this 15 year period. From 46.9 percent of all occupational FCUs in 1971, manufacturing related FCUs fell to 40.3 percent by 1985. The service sector related FCUs, however, experienced a growth in relative importance, as they grew from 17.1 percent to 21.6 percent of the total number of occupational based FCUs. This trend reflects the shift of economic resources from traditional manufacturing industries into service oriented economic activities. Also increasing in relative importance were the governmental based FCUs which reached 20.1 percent of the total number of occupational based FCUs. (This trend reflects the growing economic involvement of the public sector in the modern economy.)

In spite of the reduction in the number of operating FCUs, membership increased significantly. From a level of about 12 million in 1970, the number of FCU members reached 29.6 million by year-end 1985, which represents a 146.7 percent increase. Only in 1980 did FCU membership actually decline, albeit the fall in membership was only 1.2 percent, as the sharp economic recession largely attributed to the reduction. Nevertheless, the distribution of FCU members remained heavily skewed toward occupational based unions. By year-end 1985, occupational FCU members comprised nearly 88 percent of total FCU membership. The relative number of members in associational based FCUs was down to 6 percent, and residential based FCU membership also accounted for 6 percent.

That FCU membership increased while the number of FCUs declined is indicative of the fact that the average number of members per FCU increased

significantly. In 1970, the number of members per FCU stood at 922, by 1975 the number reached 1,343, a 45.7 percent increase. By 1980, membership per FCU reached 2,157, and by 1985 membership per FCU stood at 2,921. An increase of 61 percent from 1975 to 1980, and an increase 35.4 percent from 1980 to 1985.

A significant development with respect to the average number of members per FCU also occurred during this period. In 1970, residential FCUs had 520 members per union and occupational FCUs had 1,013. By 1985, however, this situation had completely reversed. For the first time in FCU history, residential based FCUs had more members per establishment than occupational FCUs. In 1985, the occupational unions had an average number of 3,255 members, and residential FCU membership reached an average of 3,332 members per establishment. The average number of associational FCU members also increased throughout the period, albeit at a much slower pace, reaching 1,105 members per union in 1985.

In terms of the average number of members per occupational based FCU, the governmental based unions had a greater number of members than any other FCU group. In 1970, governmental based FCUs had an average of 1,978 members per establishment. By 1975, these FCUs served an average of 3,415 members, and by 1985 the average had risen to 6,236 members per governmental FCU. The miscellaneous category had the least number of members per FCU with only 1,342 members in 1985. The other occupational based FCUs averaged in the neighborhood of 1,900 to 3,000 members per establishment.

Assets-Liabilities

Total FCU assets-liabilities reached \$8.8 billion by 1970, an increase of 229.6 percent over the 1960 level of \$2.7 billion. In 1975, assets-liabilities reached \$20.2 billion, and by 1980 they stood at \$40.1 billion. Thus, from 1970 to 1980, total FCU assets increased 354.5 percent. Assets-liabilities continued growing with vigor and reached \$78.2 billion by year-end 1985, an increase of 95 percent over 1980.

Despite rapid progress over this 15 year period, there were several years in which FCU asset-liability growth slowed to an alarmingly slow pace. FCU asset-liability growth fell to 4.9 percent in 1979, 9.9 percent in 1980, 4.5 percent in 1981, and 8.5 percent in 1982. This relatively slow growth was a result of the dramatic recession throughout the traditional economic sectors, the relatively high and volatile interest rates, and the periodic bouts of disintermediation. On the one hand, the economic decline led to a significant reduction in the financial strength of many FCU members, and, on the other hand, the level of interest rates compelled many other members to allocate their funds toward higher paying accounts offered by competing financial institutions. For instance, in 1978, the relatively high market rates of interest coupled with the introduction of the money market certificate had an immediate adverse effect on FCU savings and therefore on FCU assets-liabilities. Since most FCUs did not yet offer competitive deposit accounts to their members they suffered a substantial reduction in growth. The same held true in 1979, when it had become clear that FCUs were no longer insulated from the immediate and direct effects of competition by member loyalty. Consequently, FCUs were literally forced to

aggressively compete for their own member's funds through the issuance of higher paying deposit accounts. With these account offerings, FCUs were able to rebound so that by 1983 asset-liability growth was again on the upswing.

The distribution of FCU assets-liabilities was still concentrated in the occupational unions, as the share of total assets-liabilities of these FCUs stood at 90.6 percent at year-end 1985. Residential FCUs increased their share somewhat, rising to 5.1 percent, while the share of associational FCUs fell to a mere 4.2 percent by year-end 1985.

Among occupational based unions, the share of assets-liabilities held by the manufacturing group declined in relative importance, as it fell to 32.5 percent. This share had been falling steadily after peaking at 51.5 percent in 1951. The governmental based FCUs, on the other hand, had experienced increasing significance within the industry. By year-end 1985, these FCUs held a proportionate share of 37.1 percent of total occupational FCU assets-liabilities. In fact, 1971 marks the year in which manufacturing and governmental FCUs reversed their roles with respect to the greatest share of total occupational FCU assets-liabilities. Service based FCUs also increased their share of total assets-liabilities, as they finished 1985 with 13.8 percent of occupational FCU assets-liabilities. The other occupational FCU types, such as agriculture, construction, wholesale/retail, and transportation, communication, public utilities found their shares stabilize around the 1970s level, with only slight variation between 1971 and 1985.

As can be inferred, the average level of assets-liabilities per FCU increased greatly throughout this period. From a 1970 average level of \$682 thousand, FCUs reached an average asset-liability level of \$7.7 million by year-end 1985. Interestingly, whereas in 1970 residential FCUs averaged \$316 thousand per establishment, by 1985 these credit unions reached \$7.4 million per establishment. Occupational FCUs, on the other hand, were an average size of \$777 thousand in 1970 and \$8.9 million in 1985. The salient point to be made is that in 1970 the typical residential FCU stood at 40.6 percent of the size of the typical occupational FCU. However, by 1985, this state had altered dramatically, as the typical residential FCU stood at 83 percent of the size of the typical occupational FCU. Given the shift to a more market-oriented, cosmopolitan approach to their business, it comes as no surprise to find the multi-group based FCU growing more rapidly relative to the other FCU types. Indeed, the associational unions declined in relative size as they stood at only \$2.1 million in 1985 compared to \$269 thousand in 1970. The associational FCU has been declining in importance since the deregulation of common bonds permitted FCUs to expand into multi-group structures.

In viewing the entire spectrum of the various types of FCUs, the largest FCUs continue to be occupationally based. In 1985, for example, governmental FCUs were \$16.4 million in assets-liabilities per institution, which is by far the largest average size FCU. The next largest are the transportation, communication, public utility based FCUs as they averaged \$10.2 million per establishment in 1985. Construction based FCUs, the third largest, had an average asset-liability level of \$9.2 million per establishment. These were followed by the traditional manufacturing based

FCUs which had an average asset-liability level of \$7.2 million. The remainder of FCUs averaged less than \$6 million in assets-liabilities per establishment.

A striking point which stands out in the above analysis is the relatively low level of assets-liabilities and the relatively small size of the typical FCU. For instance, in 1984, 88.7 percent of all FCUs had less than \$10 million in assets-liabilities. Only million or greater. The majority of FCUs, 16.1 percent, fell within the \$2 to \$5 million range.

(41)

Composition of Assets

The changing composition of FCU assets is indicative of the market-driven structural transformation of the industry. The most significant development on the asset side of the balance sheet is the falling proportion of total loans outstanding relative to total assets. In 1971, the loan/asset ratio stood at 76.5 percent. This ratio continued to grow reaching 87.6 percent in 1972 and again in 1975, which were the peak years. By 1978, the combined forces of weak loan demand, loan ceiling rates, and high yields on competing assets prompted a shift in the asset structure toward external investments such as treasury bills. Consequently, the loan/asset ratio fell abruptly, from 78.3 percent in 1979 to 65.7 percent in 1980. In 1983, the loan/asset ratio was a dismal 60.9 percent. A slight recovery occurred in 1984, as the ratio rose to 66.2 percent, however, by 1985 it fell to 61.7 percent. The following table

outlines in percentage terms the distribution of FCU assets at various times during the period under review:

Table 6.6

Percentage Distribution of Total
Federal Credit Union Assets

Assets	1975	1980	1985
Loans to Members	73.6%	65.7%	61.7%
Investments			
U.S Government Sec.	1.7%	1.3%	3.1%
Federal Agencies Sec.	7.8%	6.4%	5.8%
S&L Association Shares	4.4%	11.3%	10.4%
Loans to other CUs	.5%	.4%	.2%
Shares/Deposits in CCUs	1.2%	8.1%	6.5%
Common Trust Investments	4.5%	2.4%	.8%

Source: Calculated from Federal Credit Union Annual Reports.

The changing loan-to-asset ratio is only one facet of the restructuring and shifting composition of FCU assets. The distribution of investments changed significantly by 1983 as well. The portion of assets invested in savings and loan associations and Treasury securities increased dramatically. As a proportion of total assets, the former rose from 6.5 percent in 1982 to 11.6 percent in 1983, and the latter rose from 7 percent in 1982 to 9.9 percent in 1983. FCUs have always displayed a tendency to shift their assets toward investments as loan demand declined. Since savings and loans offered relatively high rates of return during this

period, FCUs turned to this form of investment as the main outlet for their funds. At the same time, FCUs used treasury securities for liquidity purposes and for trading to gain short term income, i.e., capital gains, whenever interest rates provided an opportunity to sell the security at a price higher than book value. (42)

Historically, credit unions have never had an economic advantage in managing their investment portfolios in comparison to other financial institutions. However, credit unions quickly learned sound investment policies and practices could significantly add to earnings and, hence, to viability and growth. The current attitude among credit union management is that they rely on both relatively risk-free investments and member loans. In fact, the latter has reached such a state of concern that continuous generation of member loan demand is a priority issue for many credit unions.

According to the 1984 NCUA Annual Report, a newly emergent characteristic of FCU investment decisions is a trend toward a higher proportion of investments instruments with longer maturities. Given the current interest rate environment, The report suggested that financial performance considerations have prompted FCUs to invest in longer term assets which yield higher returns.

Except for associational based FCUs, all FCU types have displayed tendencies similar to the trends just described. The associational FCUs displayed a enormous drop in their loan/asset ratio in 1980. Upon reaching a level of 80.2 percent in 1978, the loan/asset ratio dropped to 66.6

percent in 1979. By 1980, the ratio stood at only 36.2 percent and by 1981, it dropped to 31.4 percent. Correspondingly, the ratio of savings and loan shares increased from 1.8 percent in 1978 to reach 26.2 percent in 1980. A significant share of assets were invested in corporate central credit unions, 29.3 percent of total assets in 1980. In 1981, the latter increased to 42 percent, while the share of assets invested in savings and loan shares declined to 18.9 percent. By 1982, these trends had reversed and the loan/asset ratio gravitated to industry norms.

Loans Outstanding

Loans outstanding increased rapidly during the early to mid 1970s, and peaked at a 23.9 percent rate during 1977. In 1979, loan growth dropped to 1.8 percent, and was negative in 1980, falling 7.2 percent. Loan growth continued to be dismal in 1981 and 1982, as growth registered 4.1 and 3.5 percent, respectively. Growth in loans outstanding stood at substantial levels in 1983 as it reached 17.8 percent, and over 1984, loan growth reached 26.9 percent.

The average level of loans outstanding per member in 1971 was \$526, but by 1985 this figure stood at \$1,631, which reflects a 210 percent increase in average borrowings per FCU member. In 1971, occupational FCUs continued to extend the greatest level of loans outstanding per member, \$752, compared to \$122 and \$448 for the associational and residential FCUs, respectively. In 1985, the situation was similar as occupational FCUs extended \$1,674 in loans per member and the associational and residential

FCUs extended \$1,213 and \$1,418 in loans outstanding per member respectively.

The relative position of loans outstanding per FCU member with respect to the various occupational types was similar to the trends exhibited during the 1960s. Agriculture FCUs had the greatest amount with \$2,044 in loans outstanding per member in 1985. Transportation, communication, public utilities followed with \$2,056 per member; manufacturing and finance/insurance FCUs followed with \$1,761 and \$1,739, respectively. The lowest level was found in the miscellaneous category, as loans outstanding per member stood at only \$1,173 in 1985.

Composition of Liabilities-Savings

The balance sheet items that underwent the most extensive change were those items on the liability side, particularly in the structure of deposit accounts. The deregulation of the share account brought about a proliferation of new competitive types of deposit accounts. The following displays the distribution of liabilities as a percent of total assets over the period under review.

Table 6.7

Percentage Distribution of Total
Federal Credit Union Liabilities

Liabilities	1975	1980	1984
Regular Shares	86.7%	75.6%	68.7%
Share Certificates	N/A	24.4%	31.3%
Regular Reserve	4.4%	2.8%	2.8%
Undivided Earnings *	1.2%	1.8%	2.6%
Capital	5.6%	4.6%	5.4%

Source: Calculated from Federal Credit Union Annual Reports.

* Undivided earnings are calculated before payment of the year-end dividend.

Whereas in 1975, regular shares comprised over 85 percent of total member savings, by 1985 regular shares fell to 68.7 percent of total member savings. The establishment of a credit union share insurance fund led to substantial increases in the number of large money accounts held in FCUs. For example, the proportion of shares held in large accounts doubled from 27.9 percent in 1970 to 56.3 percent at year-end 1977. These large accounts tend to be more interest sensitive than small share accounts and, consequently, FCUs are now more susceptible to movements in funds and to the resultant pressures for liquidity during episodic periods of high and volatile interest rates.

As FCUs adjusted their operations to reflect market conditions, they became more aggressive competitors for their own members' savings. Thus,

FCUs started issuing money market certificates which paid market rates of interest. The use of these savings instruments by members expanded rapidly and, by year-end 1984, 31.3 percent of FCU savings rested in share certificates. Of these, 9 percent were in IRAs and 22.3 percent were in money market certificates. Regular shares fell to only 59.6 percent of total savings, 68.7 percent of total assets in 1984. These statistical trends illustrate the extent to which members have become sensitive to interest rate conditions. Thus, FCUs realized that their viability as a financial institution was dependent on the extent to which they remained competitive in attracting their members' savings dollar.

On average, FCU members saved \$2,421 in 1985, which, when compared to \$599 in savings per member in 1971, is a substantial gain. Of the three FCU types, the occupational group had the highest average savings level per member, \$2,494 in 1985, whereas the associational and residential FCUs realized per member savings levels of \$1,713 and \$2,061, respectively, in 1985. The level of per member savings within the occupational grouping showed agricultural based FCUs with the greatest level of savings per member at \$3,218, followed by the transportation, communication, public utility group which had an average savings level of \$3,006. The manufacturing group remained relatively high as its members saved an average of \$2,742 in 1985. The lowest level was in wholesale/retail group with only \$1,260 in savings per member by 1985.

Other Liabilities

The level of reserves and undivided earnings were adversely impacted by the severe outflow of funds during the 1978-1982 period. Whereas, in 1971, the capital/asset ratio stood at 9 percent, by 1984, it had fallen to 5.4 percent. This reduction was skewed towards a reduction in regular reserves which in itself was a result of the extreme liquidity and earnings pressure that stemmed from the disintermediation of the late 1970s, early 1980s. The NCUA was forced to waive reserve transfers in 1979 for all FCUs. This action provided relief for many credit unions by making available additional revenues that could be employed to pay competitive dividends to members. The relief was shortlived as interest rates rose even higher in early 1980, causing outflows of savings and renewed liquidity and earnings pressure. The NCUA again reacted by granting a reserve waiver for the first quarter of 1981. Nevertheless, continued liquidity problems compelled the NCUA to waive reserve transfers for FCUs throughout 1981. By 1983, FCUs were again adding to their capital base, as both reserves and undivided earnings grew. However, the pace of growth was less than that of asset growth and consequently the capital/asset ratio continued to decline. This reduction was universal for all FCU types. As will be discussed in the following chapter, relatively low capital/asset ratios can create serious impediments to credit union growth and viability. Credit union regulatory authorities have thus placed emphasis on adequate capitalization. (43)

Earnings

FCU earnings in the late 1970s-early 1980s reflected the change in the asset-liability structure. Whereas loan income as a percent of total income remained consistently in the 80 to 95 percent range throughout the postwar era, in 1980 this measure fell to 74.2 percent. By 1981, it was at 61 percent, thereby reflecting the reduction in member loans outstanding. Investment income as a proportion of total income increased rapidly, reaching 32.4 percent in 1985. Service fee income, as a proportion of total income, remained relatively stable as it fluctuated in a neighborhood of 3 to 5 percent.

The major deviant from this trend were the associational based FCUs. As discussed above, they reacted quickly to the changing interest rate environment, thereby reducing member loans and increasing investments in external instruments. Thus, in 1980, associational FCUs realized only 43.5 percent of total income as income from loans, and 55.4 percent as income from investments. All other FCUs displayed trends similar with respect to the distribution of income.

By 1985, all FCUs displayed trends which were similar with respect to the distribution of their income sources. With respect to loan income, the lowest level was in the agricultural FCU with 64.2 percent of total income derived from loans; the greatest level was in wholesale/retail group with 76.4 percent of total income derived from loans. Of the three major groups, occupational FCUs gathered 71.6 percent of total income from loans;

associational FCUs pulled in 72.6 percent; and residential had a 72.5 percent share of total income derived from loans outstanding.

Return on assets grew throughout the period under review and peaked at 12.1 percent in 1981. Expenses as a percent of total assets also increased throughout, but not as rapidly as the return on assets. Consequently, the rate of return on expenses grew and peaked at 202 percent in 1981.

Footnotes

(1) For a fuller discussion of post World War II economic events and conditions see Martin Feldstein "The American Economy in Transition," and Robert J. Gordon "Postwar Macroeconomics: The Evolution of Events and Ideas," in The American Economy in Transition, edited by Martin Feldstein (University of Chicago Press, 1980). A somewhat different type of analysis is contained in Manuel Castells' The Economic Crisis and American Society (Princeton University Press, 1980).

(2) Bureau of the Census, U.S. Department of Commerce, Statistical Abstract Of The United States, 1985, (U.S. Government Printing Office, 1985) p 432.

(3) See Richard B. Freeman, "The Evolution of the American Labor Market, 1948-1970," in the The American Economy in Transition, pp 349-96.

(4) Bureau of the Census, U.S. Department of Commerce, Statistical Abstract of the United States 1986 (U.S. Government Printing Office, 1985), p 469.

(5) For an analysis of inflation and adjustments to inflation, see Robert J. Gordon, "Alternative Responses to External Supply Shocks," Brookings Paper on Economic Activity, 1975. See also "Postwar Changes in the American Financial Markets," in The American Economy in Transition pp. 9-99. For a more detailed analysis of the petroleum industry, see Walter S. Measday "The Petroleum Industry," in The Structure of American Industry, edited by Walter Adams, (Macmillan Publishing Co, 1982), pp. 36-72.

(6) Bureau of the Census, U.S. Department of Commerce, Statistical Abstract of the United States 1985 (U.S. Government Printing Office, 1985), Table 692, p. 416.

(7) See Michael Keran, "Factors Influencing Long-Term Interest Rates," Weekly Letter, Federal Reserve Bank of San Francisco, June 1, 1984 for an analysis of interest rates. See also Chapter 3 of Financial Institutions, Markets, and Money, David S. Kidwell and Richard L. Peterson (The Dryden Press, 1986).

(8) Federal Reserve Bank of Cleveland, Economic Trends, August 1986.

(9) Federal Reserve Bank of Cleveland, Economic Trends, August 1986. For a very detailed discussion of post war international trade patterns, see "Trends in United States International Trade and Investment since World War II," in The American Economy in Transition.

(10) "The U.S. Economy in 1985 and 1986," J.A. Cacy, Glenn H. Miller Jr., and Dan H. Hoxworth, Federal Reserve Bank of Kansas City, Economic Review, December 1985.

(11) Kidwell and Peterson discuss the evolution of the common bond in their book Financial Institutions, Markets, and Money, pp. 309-311. See also the Federal Credit Union Annual Reports, (National Credit Union Administration), 1980-1984.

(12) An indepth analysis of financial market deregulation can be found in Kerry Cooper and Donald R. Fraser Banking Deregulation and the New Competition in Financial Services, (Ballinger Publishing Co., 1984). Sidney Lewis Jones' The Development of Economic Policy: Financial Institution Reform, Chapter 1 and 2, (University of Michigan Press, 1979). For an analysis of the events leading to the 1980s deregulation of financial markets, see "Leveling the Playing Field," Readings in Economics and Finance, Federal Reserve Bank of Chicago, 1983. "Postwar Changes In American Financial Markets," Martin Feldstein, ed., The American Economy in Transition, pp. 1-99. Finally, see David S. Kidwell and Richard L. Peterson, "Deregulation and Growing Competition Among Financial Institutions," Review of Regional Economics and Business, April 1981, pp. 17-22.

(13) A detailed discussion of these studies is included in Jones, Chapter 4, The Development of Economic Policy: Financial Institution Reform.

(14) An interesting analysis of nonbank competition can be found in "Banks and Nonbanks: The Horse Race Continues," Christine Pavel and Harvey Rosenblum, Economic Perspectives, Federal Reserve Bank of Chicago, May/June 1985.

(15) See Timothy Q. Cook and Jeremy G. Duffield, "Money Market Mutual Funds: A Reaction to Government Regulations or a Lasting Financial Innovation?," Economic Review, Federal Reserve Bank of Richmond, July/August 1979.

(16) Paul Calem, "The New Bank Deposit Markets: Goodbye To Regulation Q," Business Review, Federal Reserve Bank Of Philadelphia, Nov/Dec 1985.

(17) The following is based on the work of Kerry Cooper and Donald R. Fraser in Banking Deregulation and the New Competition in Financial Services, (Ballinger Publishing Co., 1984).

(18) Jan G. Loeys, "Deregulation: A New Future For Thrifts," Business Review, Federal Reserve Bank of Philedelphia, Jan/Feb 1983, pp. 15-26.

(19) See Olin S. Pugh, "Credit Unions From Consumer Movement to National Market Force," Banker's Magazine, Jan/Feb 1980, pp. 19-27. Also, Gary G. Heaton and Constance R. Dunham, "The Growing Competitiveness of Credit Unions," New England Economic Review, May/June 1985.

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- (23) "The Garn-St. Germain Depository Institutions Act of 1982", Economic Perspectives, Federal Reserve Bank of Chicago, March/April 1983.
- (24) Paul Calem, "The New Bank Deposit Markets: Good-bye To Regulation Q," Business Review, Federal Reserve Bank Of Philadelphia, Nov/Dec 1985.
- (25) U.S. Department of Commerce, Statistical Abstract Of The United States, 1981 (U.S. Government Printing Office, 1981), p. 505.
- (26) U.S. Department of Commerce, Statistical Abstract Of the United States, 1985, (U.S. Government Printing Office, 1985), p. 505.
- (27) U.S. Department of Commerce, Statistical Abstract Of the United States, 1985, (U.S. Government Printing Office, 1985), p 501.
- (28) Douglas K. Pearce, "Rising Household Debt in Perspective," Economic Review, Federal Reserve Bank of Kansas City, July/August 1985.
- (29) For an analysis of Electronic Funds Transfer and credit unions, see see Pat Bator and Edward M. Eloian, "The 1985 Michigan Environmental Scan," Michigan Credit Union League, 1985.
- (30) Moody and Fite discuss the change in a credit unions relationship with its members, and the increasing importance of the affluent member. J. Carrol Moody and Gilbert C. Fite, The Credit Union Movement: Origins and Development, (University of Nebraska Press, Second Edition), pp. 300-301.
- (31) There is quite of bit of debate in the credit union industry concerning the relationship of the credit union to the membership. In general, the debate follows two lines: On the one hand, there are credit union professionals who feel that credit unions should act more like profit making banks and as a result must treat members as customers; on the other hand, there are credit union professionals who would rather that the credit union remain as it has been in the past, totally dedicated to the membership. Thus, they would go out of their way to treat members better than the latter is treated at banks. See Donald R. Welsch "An Anxious New Era Begins", Management Focus, Jan/Feb 1980.
- (32) For more on the impact of the 1979-1982 economic recession on credit unions, see NCUA Annual Credit Union Report, (National Credit Union Administration), 1980, 1981, 1982, 1983, and 1984.
- (33) Olin S. Pugh and E. Jerry Ingram, Credit Union Management, (Reston Publishing, 1984), p. 206.
- (34) NCUA 1984 Annual Report, (National Credit Union Administration).
- (35) Competition among credit unions is fast becoming a serious issue. See "Competition Among CUs," Credit Union Magazine, March 1985.
- (36) For an analysis of credit union deregulation see, Pat Bator and Edward M. Eloian, "The 1985 Michigan Environmental Scan," Michigan Credit Union League, 1985. See also, Edward M. Eloian, "Quarterly Economic Review, April 1985," Michigan Credit Union League.

(37) John T. Croteau "A New Financial Intermediary: The American Credit Union," Revista Internazionale di Scienze e Commerciali, 1971.

(38) J. Carrol Moody and Gilbert C. Fite, The Credit Union Movement: Origins and Development, (University of Nebraska Press, Second Edition). See also Olin S. Pugh and E. Jerry Ingram, Credit Union Management, (Reston Publishing, 1984), Chapter 6.

(39) See "How To Find A Good Manager", Credit Union Magazine, (Credit Union National Association), August 1985, pp. 8-10.

(40) Credit unions were not the only financial depository to experience mass failures as a result of the depressed economic conditions. See David S. Kidwell and Richard L. Peterson, Financial Institutions, Markets, and Money, (Dryden Press, 1986), Chapters 12 and 13.

(41) A good analysis of credit union assets relative to other financial depositories is in Olin S. Pugh and E. Jerry Ingram, Credit Union Management, (Reston Publishing, 1984), Chapter 6.

(42) Pat Bator has written an excellent analysis of credit union investments in "An Investment Guide For Michigan Credit Unions," Michigan Credit Union League, December 1985.

(43) Adequate capitalization has become a serious issue with credit union regulatory authorities. See Olin S. Pugh and E. Jerry Ingram, Credit Union Management, (Reston Publishing, 1984), pp. 80-81.

CHAPTER SEVEN

The Business Of Modern Credit Unions

With the advent of the 1980s, the financial service industry began capitalizing on the government's trend to deregulate financial markets. Through early 1984, the restructuring of the financial industry focused primarily on price deregulation. However, with the growing market presence of many new firms offering a full array of financial services, the definition of deregulation expanded into both product and geographic dimensions. (1)

Price deregulation refers to the easing of the legal restrictions on the interest rates depository institutions pay to obtain funds, and to a lesser extent, on the rates that they may charge for loans. The fact that deposit rates became subject to markets fluctuations correspondingly exposed financial depositories to interest rate risk. Interest rate risk arises out of the mismatch in the maturity structure between assets and liabilities. For instance, thrifts that have locked themselves into long-term, fixed-rate assets are more vulnerable to sudden upward movements in interest rates which can cause the cost of borrowing to rise more quickly than an increase in the average return on assets. As a result, earnings fall as narrower profit margins are realized. Such a trend is in contrast to the disintermediation phases that shook depositories because they were unable to adjust deposit rates to remain competitive.

Product deregulation refers to the removal of the restrictions placed upon banks and other depository institutions in the types of services offered, such as investment services and individualized financial

planning. A financial depository's rapid diversification into multiple product lines increases its future exposure to credit risk. Specifically, such risk can not be identified in a case of a new product offering that has no market past from which to estimate its future profitability.

Geographic deregulation refers to the removal of the restrictions that prohibited depository institutions from expanding business operations across regional boundaries, such as state lines. Such an expansion across regional boundaries increases both a financial institution's propensity to economic risk as well as credit risk. Economic risk can materialize and manifest itself as a result of a secular downturn in economic activity in a certain region. Increased credit risk also becomes a problematic in that credit is extended to markets outside the immediate local of the granting institution.

Credit unions are affected by all of these changes in addition to the fact that credit union members have grown sophisticated in their product demand and in their sensitivity to interest rate differentials. Members no longer are tied to their credit union as they were in the past. In today's financial environment, they view their credit union from a utility maximization/cost minimization perspective. Members are simply after the "best deal" they can get for their funds, and if their credit union is unable to provide such a deal, they will move their funds elsewhere. Credit unions have therefore been forced to alter the composition of their asset/liability structures in order to retain member business. (2)

The motivation to deregulate the credit union industry stems from those same market driven forces that have motivated the deregulation of other depository institutions. On the one hand, credit unions are affected by the conditions in financial markets as members have grown increasingly sophisticated and, as a result, demand financial instruments that not only support their financial goals, but insulate their funds from inflation and therefore erosion. On the other hand, credit unions are severely affected by the events occurring on the economic front. Evidence the dismal economic conditions of the late 1970s-early 1980s as many credit unions exhibited their vulnerability to those economic conditions and their members' unemployment. As a result, many credit unions were forced into merger or charter expansion to avoid liquidation.

As a result of these events, credit unions are now competing vigorously against the giants of the financial service industry. Consequently, they have had to adjust their operations to account for the fluctuations in financial market conditions. Thus, as briefly discussed in the previous chapter, credit union management is exposed to financial market conditions that demands much more of them than the conditions of a regulated environment. In some instances, management rose to the occasion and performed admirably, whereas in other instances, management was unable to weather the new competitive pressures.

Regulatory authorities (federal and state agencies) continue to realize that they cannot through regulation ensure the success of credit unions. Consequently, the NCUA continues to monitor conditions in the financial service industry to provide credit unions with the regulatory

adjustments that they need to compete. The following details the responses of the credit union regulatory authorities to the events that have shaped the current structure of the financial industry. It also examines the nature of the credit union industry response in terms of operational adjustments and managerial practices. (3)

Deregulation

The United States economy is undergoing a structural adjustment from a manufacturing based economy to a high-tech, information-based, service oriented economy. This transformation is typified by the secular rise in unemployment in the traditional manufacturing sectors, as many firms have and/or are in the process of converting to labor saving automation. (4)

The credit union industry was dramatically affected by this transformation. As shown in the previous chapter, occupational based FCUs were severely impacted by the recession of the late 1970s, early 1980s. In response to this economic state, the National Credit Union Administration (NCUA) extended to FCUs greater latitude to expand their charters as an alternative to liquidation or merger. The NCUA acted in the spirit of both deregulation and decentralization, and within its policy to preserve the assets of the credit union share insurance fund, since credit union liquidations place a drain on the fund.

In order to stop relying on a single source of financial support, and thereby assure solvency and stability, FCUs were permitted to broaden their economic base through expansion of their membership charter. Consequently,

FCUs were afforded the capacity to create a marketplace structure or niche that would assure a stable turnover of assets and that would partially insulate them from the negative impact of of an another economic dislocation. (5)

The NCUA developed specific policies and procedures with respect to charter expansion of FCUs, which are used as criteria for granting charter expansions that encompasses fields of multiple groups. The NCUA regional directors as empowered by the NCUA Board of directors have the authority to grant or deny charter expansion on a case-by-case basis. Five requirements must be met in order for a regional director to grant a charter expansion for a FCU. These requirements are as follows:

1. All affected groups must have requested service from the expanding credit union.
2. The expanding credit union must display that it can provide service to each group.
3. The application by the expanding credit union must be economically feasible and advisable.
4. The expanding credit union must indicate whether the affected groups are eligible for membership or are being served by any other credit union. If those groups eligible for membership are being served by another credit union, the groups must provide justification why they no longer desire continued service from their credit union. (6)
5. All of the affected groups must be within the operational area of the home or branch office of the credit union.

The aforementioned are the procedural requirements for FCUs with occupational or associational common bonds interested in charter expansions. For community based FCUs interested in charter expansion, the combined field of membership is limited to a well defined neighborhood, community or rural district, as determined by the regional NCUA director,

in addition to the above criteria. If a FCU meets all these requirements, the regional director will approve a charter expansion.

With respect to the competitive infringement on another credit unions' market (i.e., overlap), the NCUA has no detailed policy set. However, the NCUA does feel that if there is a potential overlap situation the issue will be resolved depending upon whether the infringed upon credit union is serving its members in an optimal, and acceptable manner. If a credit union is judged as not doing its job, then an overlapping field of membership condition will be approved. In general, the NCUA policy is to foster an environment in which FCUs can provide credit union service to those individuals who currently do not have it. (7)

The membership or common bond requirement, of falling within a given field of membership, long held by credit union authorities as the only approach to successful and sound credit union operations, has been rendered archaic by recent economic events. For all practical purposes, the theory of the common bond has become obsolete and credit unions are now able to serve the general populace. From a regulatory standpoint, this event eliminated the essential distinction between credit unions and their traditional rivals, banks and thrifts.

The widespread use of the NOW account is symbolic of the highly competitive state of today's financial markets. NOWs, like credit union share drafts, are interest bearing accounts that permit withdrawals on the basis of checks drawn on that account. The balance of the account earns interest until the the withdrawal is formerly debited. The acceptance of

this product led non-depository financial institutions to develop similar consumer financial instruments, such as the money market mutual fund account. Predominately offered by unregulated financial firms, many of these mutual funds provided a limited checkwriting service.

Prior to March 1980, credit unions with their share draft programs were the only depository institution to offer a true interest-bearing transactions account. As suggested above, the "non-bank" financial institutions have had the ability to offer a like financial product for sometime as they were not subject to formalized regulation. With the enactment of the Depository Institutions Deregulation and Monetary Control Act (DIDMCA) of 1980, all banks and thrifts were empowered to offer NOW accounts, effective December 1980. Congress was prompted into this action as a result of the in-roads made by the "non-bank" banks into the regulated financial community's market. Congressional intent was to create an atmosphere of competitive equity, a "level playing field", for all financial service institutions.

The NCUA followed with its own wide-sweeping deregulation in April 1982, as the NCUA Board of Directors voted to revise the regulations that govern the share, share draft and the share certificate account terms and conditions, and operational procedures thereof. Credit union boards were, as a result, put into a position where they became responsible for pricing decisions with respect to share, share draft, and share certificate accounts which previously were subject to regulatory constraints. For the first time, credit union management became responsible for the structure of the deposit accounts offered. Moreover, credit union boards were placed in

a position that they became solely responsible for the operational health and safety of their credit unions. Thus, credit union board of directors were swept into the current situation in which only efficiently run credit unions should be permitted to operate, the others were "allowed" to go under. (9)

Specifically, credit union boards were authorized to declare dividends on all accounts. This authority, in turn, required that dividends be based on current and prior earnings available after the statutory allocation to required reserves. Also, boards were authorized to declare dividends to be paid at: 1) different rates on different types of shares; 2) different rates and maturity dates in the case of share certificates; and 3) different rates on different types of share draft accounts.

It was further stipulated by the NCUA that a FCU was required to disclose accurate information to members concerning the terms and conditions of its share, share draft, and share certificate accounts. This applies to all advertisements, disclosures, or account agreements--written or oral--that a credit union may employ. This rests the responsibility of designing specific procedural and operational guidelines upon the management of the credit union. Essentially, credit unions have been given the responsibility for establishing and implementing their own saving program without the constraint of umbrella regulation.

Many FCUs, at this time, were concerned that they would be unable to compete with the money market mutual funds because their new rules did not specifically authorize such an account. However, those FCUs were not

familiar with their new found freedom. They quickly realized that deregulation to the extent offered by the NCUA gave them unlimited freedom in terms of structuring their deposit accounts. At the same time, banks and thrifts experienced similar freedom in structuring their accounts (e.g., Super-NOWs). Thus, credit unions and other financial depositories, in a short period of time, observed that funds which left a year before flowed back to them. Such a trend suggests that the consumers only wanted to earn higher interest rates on their savings, rather than wanting a structural change in the institutional manner whereby financial services would be delivered.

Interest rate deregulation was purely a function of market driven forces, spurred by consumer demands for the highest possible interest return on savings. However, financial product deregulation was not. In the late 1960s, non-bank banks emerged and showed their willingness to compete with depository institutions. The result, as alluded to, was an incredible growth of money market funds that drained billions of dollars from the traditional depositories. Because of the regulated environment, many financial depositories were pressured to emphasize service to consumers as a means to replenish their deposit bases. Competition heightened further as an array of new financial products and services become available from a host of nontraditional providers such as Sears, J.C. Penny, K-Mart, Shearson Lehman/American Express, and Merrill Lynch, among others. These nontraditional financial institutions offered, either directly or indirectly through their subsidiaries, a gamut of products such as credit cards, mutual funds, securities, etc., to consumers--all the while avoiding regulation. (10)

The emphasis on attracting consumers is the direct result of both the traditional and nontraditional institutions' need for capital. Capital formation gives both types of institutions a means to weather economic problems and a means to be innovative in the development of new products and services. Financial industry analysts have projected that over the next decade, the growth of capital will be generated from retained earnings. This means:

1. All financial institutions must engage actively in strategic planning to create an atmosphere which fosters a consistent and reliable turnover of assets.
2. All financial institutions will have to find ways to add to net income. This means emphasizing production efficiency and enhanced automation processes, thereby replacing high-cost, labor intensive activities. Smaller financial institutions may well have to purchase financial services through correspondents or third party vendors rather than develop products and services internally.

Credit unions are no less in need of an adequate capital base than are other financial institutions. Indeed, it is an adequate capital base which provides the foundation for an institution's sustained growth and maintenance of market share. Credit unions have realized that an adequate capital base is a necessity if they are to stay abreast of their competitors and have the capacity to repel attempts to penetrate their traditional markets. (11)

Indicative of the competitive nature of the financial services industry, the Federal Reserve Bank of Atlanta conducted a consumer survey in May of 1984. The survey found that 50 percent of those responding considered it desirable to obtain all financial services at one location. Known in the financial services industry as the "financial supermarket",

this method of service delivery was promulgated by Sears (e.g., financial planning and securities--Dean Witter; insurance--Allstate; real estate--Coldwell Bank). The trend in consumer attitudes toward financial service delivery systems has elicited a change in the credit union method of delivering financial products to its members. (12)

In the early 1980s, the NCUA observed that credit unions were greatly disadvantaged in terms of providing certain levels of service delivery to credit union members. In order to remain a viable financial alternative, the NCUA began looking at deregulating a FCU's investment in a credit union service organization (CUSO). A CUSO is a business organization established by a credit union or group of credit unions to provide products and/or services to itself, its members and/or other credit unions. (13)

With its ruling in 1982, the NCUA extended to FCUs the authority to establish CUSOs. The new regulation reaffirmed a FCU's authority to invest up to 1 percent of its total unimpaired capital and surplus in the shares, stocks, or obligations of any organization providing services which are associated with the routine operations of the credit union. In addition, a FCU may make loans of 1 percent of unimpaired capital and shares to such organizations.

The new NCUA regulation outlined the permissible CUSO activities. FCUs were permitted to become involved in the following business activities:

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- Family financial planning services
- Credit union operational functions
- Personal property leasing
- Insurance agency activities

The intent of providing categories was to suggest areas of CUSO activity and not to limit the scope of what products/services a CUSO could provide. In fact, any activity, service, and/or product associated with a credit union's routine operation became permissible. Consequently, the NCUA extended to FCUs a great deal of flexibility to identify their membership's needs and to develop product lines and service delivery systems accordingly.

In addition, the NCUA allowed FCUs to establish a profit making CUSO in a business form of their own choosing. Although having had the power to establish CUSOs since the 1960s, the CUSOs had to be nonprofit entities. This nonprofit provision was the principal factor deterring credit unions from forming CUSOs. Prior to deregulation only 12 FCU CUSOs were in existence.

In so far as CUSOs could take on any business form desired, they could be a corporation, partnership, limited partnership, or joint venture. Formerly, CUSOs were restricted to the corporate form. The new regulation, however, permits CUSOs to not only service credit union members but also the general public. The NCUA, however, reserved the right to subject a CUSO to examination to the extent permitted by law.

This new freedom provides credit unions with the flexibility to generate additional sources of income (i.e., capital) to establish their own autonomy by developing their own service systems, thereby generating better control over their expenses and pricing of products and services.

In addition to the benefits of a CUSO, CUSO activity also exposes credit unions to added risks. These risks include:

- The investing (parent) credit union may lose its investment and might be held accountable for other liabilities if the CUSO fails.
- A CUSO that fails may risk the loss of goodwill and confidence of the membership of the parent credit union.
- A CUSO can place additional demands on a credit union's staff and management.
- Ownership of corporate CUSOs may expose to questions of competing interests with the parent credit union.

With the passage of time, both the advantages and disadvantages of CUSO activity have materialized. From a regulatory standpoint, however, the negatives have had a more sweeping impact than have the success stories. Consequently, in 1986 the NCUA revisited the CUSO issue and have become more stringent in their approach toward CUSO activity. Because of significant losses to the National Credit Union Share Insurance Fund, NCUA enacted a new CUSO regulation to alleviate the extant abuses. The new regulation limits the business structure of a CUSO to a corporation and/or a limited partnership. Both of these forms extend to an investing credit unions limited liability and ensures that FCUs will not be exposed to potential losses in excess of its funds invested in or lent to a CUSO. This, in turn, will limit the risk exposure of the share insurance fund. The new regulation also clarified the list of permissible activities of a

CUSO. The most extensive change made by the new regulation was the prohibitions against insider dealings and conflicts of interest. It was in these two areas that the NCUA, through its investigation, noted the most abuses and threats to the share insurance fund.

Credit Union Management Tools

In general, with the changes in the financial service industry, the future of the credit union industry will be determined by the success of individual credit unions in adapting to their environment. An integral element of success is anticipating the impact of financial market changes and developing strategies to either take advantage or offset those changes. Thus, in many respects, credit unions have shifted their operational styles from a reactive stance to that of a proactive posture and have begun to change the way in which they relate to their traditional markets. (14)

As just discussed, To successfully operate a credit union in today's financial markets, credit union management must adjust quickly to evolving market forces. An essential element is the initiation and implementation of a comprehensive strategic planning program. Strategic planning involves the analytical formulation of objectives and goals coupled with an analysis of future economic and financial market events. A vital component in addition to strategic (long-range) planning is the day-to-day tactical adjustments necessary to achieve a given set of strategic goals. Strategic planning and its tactical counterpart are methods whereby credit unions can minimize the economic risk inherent in doing business in today's volatile financial markets.

The following outlines the various methods credit unions have been introduced to assess their unique characteristics in relation to their markets and to financial markets in general. Also included in the discussion is a description of the new techniques and tools which credit unions have been introduced to minimize their exposure to the risks inherent in financial market competition.

Credit unions and/or their service providers have begun to employ methods which allow them to scientifically assess their "market". Many have turned to a marketing technique known as "target marketing", which is an attempt to isolate certain member characteristics (demand, demographic, etc) and to provide those products that are coincident with these characteristics. (15)

In gathering information to use in their marketing efforts, credit unions generally employ a survey approach to compile a strategic profile or information base about their memberships. The gathered information details who their members are; how much members earn; lifestyle characteristics; and other types of demographic characteristics. In addition to these characteristics, credit unions have attempted to discover the types of products/services that appeal to most of their memberships. Also, competitor information has been readily gathered and assessed through an analysis of the competitive influence on members.

As membership bases have become increasingly diversified, this type of market information has grown increasingly important. (The diversity is directly related to the evolution and expanded definition of the common

bond.) Credit unions have discovered that as members pass through the stages of the life, such as young adults, two income households, households nearing retirement, retirement households, and households at varying stages in between, their financial needs change. Many credit unions have responded to this discovery by designing service delivery systems that most closely reflect the needs of their members.

For instance, a key factor in America's economic development is the gradual aging of the population segment known as the baby-boom generation. This segment of the population (people between the ages of 25-45 years) is not only the most productive, but the fastest growing segment. From a credit union service standpoint, this population group--with its favorable education, occupation, and income characteristics--will create a great demand for housing, durable goods, recreational products, and financial services such as savings and retirement plans. Many credit unions have therefore responded by specifically designing their array of product/service offerings to meet member demand.

The importance of target marketing stems from the fact that consumers, and particularly today's credit union member, are more aware of the impact of economic conditions on the value of their funds. As a result, they are inclined to shop for the optimal, highest return/least cost level of financial service. Many credit unions have recognized this and have adjusted their operations to cater to the special needs of their membership. With the rapidly changing economic environment of today's high-tech economy, many credit unions have also learned to stay abreast of their member's changing demand for financial products/services. Credit

unions that came to this realization are most likely to retain their members. Moreover, and most importantly from a strategic planning perspective, as credit unions develop detailed information on their member's characteristics, they are placed in an excellent position to understand how changes in the economy will affect members and thus future credit union operations. In other words, credit unions are in a better position to plan their future actions.

The most important challenge facing the credit union industry and the one that requires the greatest amount of expertise is the management of risk. As outlined in Chapter One, financial institution risk exposure occurs in five basic dimensions. All these types of risk can be controlled except for economic risk which is an exogenous force that can only be monitored. The matching of assets and liability maturities, especially in the shorter ranges, tends to minimize both interest rate and liquidity risk. Careful credit granting procedures and intense scrutiny of potential borrowers reduces the level of credit risk. Also, by monitoring the scope and nature of its decisions, management can reduce an financial institution's exposure to managerial risk.

The other side of risk is profitability, and in all cases, the reduction of risk must be accompanied by a reduction of the returns from assets held. The challenge facing credit unions and the credit union industry is to devise and adopt strategies which allow credit unions to maintain favorable interest rate spreads without exposing them to the danger of excessive risk.

The proper choice of analytical tools is essential to manage risk. In today's credit union industry, analytical techniques have appeared that are designed to provide information which acts as the basis of sound risk related management decisions. Before the assessment of risk exposure is made, it is generally advisable that a credit union develop a strategic plan. The purpose of the plan is to establish clearly: A) the direction in which the institution is going; B) the management philosophy guiding it; and C) the steps that will have to be taken over the course of the plan to reach the goals and objectives set forth in the plan. Vitally important, especially for risk management purposes, is the inclusion of a financial-economic forecast that delineates the environment a credit union can expect to operate within over the course of the plan. The forecasts should cover specific or local markets as well as aggregate financial and economic trends which will affect the credit union such as interest rates, inflation, unemployment, and international trade flow, etc.

Traditionally, both management and credit union examiners have used the loan-to-share ratio to determine a credit union's loan (portfolio) capacity. However, in today's economic environment, dependence on loan/share ratios can result in significant balance sheet mismatches that could expose a credit union's earnings to unintended interest-rate risk. The degree to which variable-rate assets (primarily loans) differ from variable-rate liabilities (or, in other words, the amount of variable-rate assets supported by fixed-rate funds) can cause a severe earnings problem for a credit unions. An imbalance, or gap, measures the exposure of a credit union's net interest margin, that is, interest income less interest expense, to unexpected changes in market interest rates. An interest rate

increase can result in losses if credit union is funding long-term fixed rate assets (member loans) with relatively short-term liabilities (member share accounts) Losses can also occur if a credit union uses relatively fixed rate long-term funds to finance assets and interest rates fall. As a result, credit unions have recognized the importance of managing the gap between interest sensitive assets and liabilities in order to reduce the extent of interest rate risk.

To minimize their exposure to interest rate risk, some credit unions now employ a matching of the maturity structures between their assets and their liabilities. The maturity gap, as it is called, is the difference between interest rate sensitive assets and interest rate sensitive liabilities, where rate sensitivity generally refers to funds whose maturity structure is less than one year. The gap, which is the focal point of the concept, results from a mismatch in the maturity structure of assets and liabilities.

In a typical gap management process, credit unions list all items, both assets and liabilities, on the balance sheet according to interest sensitivity. An asset or liability with an interest rate subject to change within a year is considered interest rates sensitive and thus variable. Taking the difference between the assets and liabilities, a positive gap means that a credit union has more interest sensitive assets than liabilities. As interest rates change, the yield on assets will adjust more quickly than the cost of funds. A zero gap means a credit union has the same amount of interest sensitive assets and liabilities. As interest rates change, the yield on assets will adjust at the same speed as the cost of

funds. With a negative gap, the credit union has more interest sensitive liabilities than assets. A change in interest rates will cause a faster adjustment in the cost of funds than in the return on assets.

The maturity gap model is only the beginning to a more sophisticated method of measuring interest rate exposure known as duration analysis. With duration analysis, each asset and liability is assigned a maturity based on its cash flow characteristics. The total interest rate exposure of a credit union depends on the duration of its liabilities relative to the duration of its assets. Technically, the duration of any security is the weighted (by time until receipt) discounted cash flow from the security. The net worth of a credit union is immunized against interest rate movements when the market value of assets times the average asset duration is equal to the market value of liabilities times the average liability duration. (17)

An important, if not essential, assumption of duration analysis is that economic values (market driven values) are vital to the efficient management of credit union asset/liability portfolio. The importance of using a economic value rather than a book-value approach is that the resulting relationship is based on market-driven formulas and, as such, presents a more accurate picture of how changes in market conditions will affect a credit unions financial performance. What duration attempts to do is to collapse the time structure of economic benefits and costs (cash inflows and cash outflows) into a single number which can serve as an indicator of the extent of a credit union's interest rate exposure.

The data needed for duration analysis consists of information on cash flows, periods in which the flows are received and present value factors. Using this data, the duration of assets and liabilities can be calculated. Nevertheless, the problem of financial management remains, as a choice must be made with respect to the level of interest rate exposure desired. On the basis of the chosen level, the credit union's portfolio will be restructured in that direction.

While from an economic perspective, the use of duration analysis is conceptually correct, credit unions have a long legacy of book value analysis and thus have found it difficult to conceptualize the duration approach. The paradox, however, in this position is that credit union management generally values long-term fixed asset acquisitions in terms of economic value, but has not adjusted its analysis to the measurement of member's shares and risks in economic terms. The salient point is that, the tools exist which allow credit unions to measure and alter their risk exposure.

To most credit unions, the previously discussed methods have proved difficult to employ practically. Consequently, they have turned toward less sophisticated techniques. The most widely used of these methods is financial ratio analysis. The key in using financial ratios is to select those ratios that capture the information which is indicative of a credit union's financial condition. In general, credit unions should employ ratios that highlight financial strengths and financial weakness; which detect trends over time so that a credit union's performance can be viewed in terms of historical experience, and in terms of the historical

experience of credit unions in the aggregate; and, which are useful for cross-section financial performance analysis with respect to a credit union's peer group.

It is also important to analyze a credit union's financial condition in terms of profitability, interest rate sensitivity, loan quality, capitalization, and reserve adequacy. Unfortunately, no single ratio contains all this information.

The capital/asset ratio is probably the best overall indicator of a credit union's capitalization. Capital--reserves plus undivided earnings--provides the financial base for future growth (i.e., enhanced member service) for a credit union. As discussed above, an overriding necessity for financial institutions over the next decade will be the generation of internal capital sources. Consequently, credit unions Credit unions have turned toward the retention of greater amounts of undivided earnings to fund capital accumulation. Whereas reserves are determined through regulation, undivided earnings are a credit union management decision. It has been recognized by credit union management that the increased competition of recent years has strained credit union earnings. Thus, undivided earnings have been shifted to a type of "earnings buffer", which insulates credit unions from the adverse impacts of volatile economic conditions.

Well-capitalized credit unions are generally more profitable than credit unions with relatively low capital/asset ratios. Since a high capital/asset ratio allows a credit union to finance a greater percentage

of assets with funds on which dividends are not paid (undivided earnings), the cost of funds will be lower and return on assets will be higher. In addition, highly capitalized credit unions can afford to pay relatively competitive deposit rates without negatively impacting profitability. In general, credit unions with capital/asset ratios exceeding 8 percent are well capitalized; those with ratios in the 3-4 percent range are marginal; and those below 3 percent are poorly capitalized and are likely to experience severe profitability problems in the future. (18)

Whereas capitalization (capital/asset ratio) pertains to a credit union's capacity to generate net earnings, i.e., profitability, reserve adequacy measures the sufficiency of a credit union's total reserves to loans that are likely to be charged off against those reserves. The two concepts are distinct in that a well-capitalized credit union could be under-reserved relative to the quality of its loan portfolio.

To accurately measure a credit union's reserve adequacy, a ratio is employed that relates potential loan charge-offs (loans that are never paid) to that portion of total reserves which have been set aside for that purpose. Undivided earnings are excluded when considering the adequacy of reserves because they are not statutory accounts. An indicator of reserve adequacy is the delinquent loans reserves/asset ratio. This ratio is determined by dividing the dollar amount of loans more than two months delinquent by total reserves. However, this measure assumes that all delinquent loans have the same quality, which is questionable because the collectibility of a delinquent loan typically diminishes the longer the loan is delinquent. (19)

To statistically account for the aging of delinquent loans, credit unions have turned to a delinquency factor. In using delinquency factors, delinquent loans that are aged 2-6 months, 6-12 months, and over 12 months are assigned a probability of eventually being charged off. This probability can be arbitrary or based on historical experience. The delinquency factor (expressed in dollar amounts) is determined by multiplying the dollar amount of delinquent loans in each aging category by the category's respective charge-off probability and then summing the results. In using the delinquency factor, a credit union can measure reserve adequacy by the delinquency factor/reserve ratio. This ratio provides an estimate of the proportion of total reserves that are expected to be charged off. (20)

A secondary measure used to support the delinquency factor/reserve ratio is the ratio of net charge-offs (loan charge-offs less recoveries) to net operating income (net income after dividends but before reserve transfers). This ratio signifies the percentage of net operating income that is being used to cover current loan losses. When used in tandem the two ratios provide an accurate assessment of a credit union's reserve adequacy. The delinquency factor/reserve ratio depicts reserve adequacy in a static sense, whereas the net charge-offs/net operating income ratio adds a dynamic insight from a flow-of-funds perspective. (21)

The reserve adequacy ratios just discussed are the main indicators with respect to loan quality. However, further evidence on loan quality is available through the ratio of annualized net charge-off to average loans outstanding during the measured period. This ratio tends to indicate the

quality of a credit union's loan portfolio. Generally, a lower net charge-offs/average loans outstanding ratio indicates good loan quality.

Footnotes

- (1) On these aspects of deregulation, see John Heinmann, "Market-Driven Deregulation of Financial Services," Economic Review, Federal Reserve Bank of Atlanta, December 1984. Also, Thomas Bundt and Barry Keating, "Depository Institution Competition in the Deregulated Environment: The Case of the Credit Union," Working Paper, Notre Dame, Fall 1986. And David S. Kidwell and Richard L. Peterson, "Deregulation and the Growing Competition Among Financial Institutions," Review of Regional Economics and Business, April 1981.
- (2) J. Barry Mason, Frederick W. Langher, and James Lollar, "Targeting the Credit Union Customer", Journal of Retail Banking, Fall 1984.
- (3) H. Black and R. H. Dugger, "Credit Union Structure, Growth, and Regulatory Problems," The Journal of Finance, May 1981.
- (4) For a brief assessment of the structural shift in the economy and its impact on credit unions, see The 1984 NCUA Annual Report, National Credit Union Administration.
- (5) Evolution Of Credit Union Fields Of Membership, Michigan Credit Union League, 1985.
- (6) This requirement was designed to alert regional directors to potential overlap into another credit unions field of membership. The NCUA encourages FCUs to develop a solution to an overlap problem between themselves. If resolution appears to be a problem, and other circumstances warrant an overlap, then the NCUA will permit the overlap.
- (7) Disputes Between Credit Unions, Michigan Credit Union League, 1985.
- (8) David S. Kidwell and Richard L. Peterson, Financial Institutions, Markets, and Money, (Dryden Press, 1986), Chapter 8.
- (9) H. Black and R. H. Dugger, "Credit Union Structure, Growth, and Regulatory Problems", The Journal of Finance, May 1981.
- (10) Christine Paval and Harvey Rosenblum, "Banks and Nonbanks: The Horse Race Continues," Economic Perspectives, Federal Reserve Bank of Chicago, May/June 1985.
- (11) See "Not for Profit, but," in the special issue of Perceptions, Georgia Credit Union League, Summer 1985.
- (12) J. Barry Mason, Frederick W. Langher, and James Lollar, "Targeting the Credit Union Customer," Journal of Retail Banking, Fall 1984.
- (13) CUSO: A Guide to Organization and Management, Michigan Credit Union League, 1983. Also, "Leagues and Regulators Look At CUSOs", Credit Union Magazine, Credit Union National Association, December 1984. This section benefited from numerous discussions with Patrick Bator, Senior Product Development Specialist, of the Michigan Credit Union League.

(14) The following material is derived mainly from the courses at Credit Union Financial Management School, put on by the Credit Union National Association, which the author attended while working at the Michigan Credit Union League. Also, see "Planning," Credit Union Magazine, Credit Union National Association, November 1984.

(15) See Credit Union Magazine, Credit Union National Association, December 1984, for a special section on target marketing credit union objectives.

(16) Bob Von der Ohe, "Forecasting and Matching," Impact, Credit Union National Association, 1981. Also, The Fundamentals of Asset/Liability Management, Dr. Charles H. Idol, Chief Economist, Texas Credit Union League & Affiliates.

(17) Based on information gathered at Credit Union Financial Management School, (See note 14 above). Also, "Asset/Liability: Learning To Live With Duration," United States Banker, August 1985.

(18) "Not for Profit, but," Perceptions, Georgia Credit Union League, Summer 1985, contains analysis on the necessity of credit union capital and adequate profitability. Also, William Cox, "Capital Adequacy: How Much Is Enough," Executive, Credit Union National Association, Winter 1985.

(19) See the series of articles by Dr. Charles Idol and Darrell Scott "Rethinking Ratio Analysis," "Ratio Analysis By The Right Numbers," "Warning: Loan-To-Share Ratios May Be Hazardous To Your CU's Gross Spread," Credit Union Management, Credit Union National Association, November 1984, December 1984, February 1985, respectively.

(20) Ibid.

(21) Ibid.

CHAPTER EIGHT

Summary and Conclusion

The emergence of credit unions marked the initiation of formal financial intermediation on behalf of the "common" wage earner. The purpose of these early unions was to provide a basis for thrift and credit for people of meager means. Credit unions, it was claimed, would prove that economic democracy and the brotherhood of man was attainable in practicality. Indeed, to many of the early leaders of the credit union movement, credit unions were the source of humanitarian and philanthropic reform, an agency that fostered a democratic system of economic and financial well-being. Unlike the early 20th century socialist movements, the credit union movement was in no way anticapitalist. The founders were committed to eliminating the harsh and exploitative aspects of the capitalist system while, at the same time, working within the given parameters of the system. Thus, the force of the early credit union movement was aimed at the elimination of exploitative money lending.

As discussed in Chapter 3, many of the early credit union leaders took a philanthropic outlook. It was Filene's contention, however, that credit unions were to play an integral role in keeping the machinery of mass production from coming to a standstill. He saw credit unions as an economic entity that would supply widespread credit to the masses, and it was the mass of wage earners who in turn would provide the necessary purchasing power to keep the "mass production system" from overproducing and therefore out of economic chaos. In so far as he saw the role of credit unions as a lubricant in the mass distribution of consumer goods through

the provision of consumer credit, he was years ahead of his time relative to the immediate possibilities of his era. However, it was the philanthropic idealism which held sway and credit unions, for the most part, operated under the semblance of cooperative, mutual self-help societies, with the financial well-being of men as their proclaimed purpose.

From this ideological foundation there grew a body of literature that emphasized and analyzed the nature of credit union operations in terms of a mutualistic society. John Croteau rose to the forefront as the economist of credit unions. Croteau's work formalized the conception of credit unions as "an extension of the economy of the household." As such, Croteau stated, the credit union

"exists only to promote the interests, economic and social, of its membership--households united under some common bond. And although it may be chartered as a legal entity and exist as an incorporated company, it has no incentive, no independent economic goals, other than the welfare of its household members.... (and) despite the economist's well-developed vocabulary to describe a variety of market conditions, or a firm's cost and revenue functions, or national income and product aggregates, it is difficult to find the appropriate economic terminology to describe neatly and adequately the unique nature of the...credit union." (1)

During Croteau's era (1945-1970), the mere mention of the concept of profit on the part of credit unions was considered fundamentally inappropriate since credit unions were not in business to earn a profit. Instead, they were in business to provide essential, low-cost financial services to its members. Furthermore, according to Croteau, because of the value system underlying credit union operations, the use of scientific economic principles is useless. Indeed, according to Croteau, the credit

union's "ethical and social values, its mystique--carries a significance beyond the mere economic" principles of modern economic science. (2) In his book, "The Economic Dimension Of Credit Unions", Croteau writes:

"Credit unions are not intended to do a general banking business, but to serve the savings and credit needs of well-defined groups, associated under a common bond." (3)

The concept of "mystique", the ethical and social values of a credit union, is formalized as thus:

"Credit unions seek to protect the weak, to save them from the exactions of usurers. They emphasize voluntary action, the democratic dream, the development of the latent abilities found in the common man. These explicit values are not amenable to economic analysis, but they cannot be ignored by any one who would understand the credit union." (4)

Croteau's vision was not housed in isolation as the entire credit union ideological superstructure, from state trade associations to the smallest credit union, was erected on this basis. That the credit union ideal was built on such a "vision" can hardly be denied. Nevertheless, this dissertation has taken a radically different approach to the study of the nature of credit unions. Rather than begin with the ideal, this dissertation began from the historical, and, in so doing, analyzed the nature of credit union development. within the context of economic and historical necessity. Specifically, this dissertation attempted to argue that fundamental changes which occurred in the structure of the U.S. economy not only gave birth to credit unions but ultimately led to a transformation in the practical nature of credit union operations.

In general, the emergence of credit unions was shown to be a function of the evolution of capitalism in Europe. The destruction of feudal relations of production left the peasantry at the mercy of impersonal market forces. Without a means to finance the acquisition of resources, goods could not be produced for the market. A means which financed these resources was cooperative credit. Cooperative began initially in Germany as a dual system of urban and rural credit societies and then spread throughout Europe and Canada.

The first stirrings of cooperative credit in the United States came as a solution to the perceived problem of exploitative money lending or loan sharking. It was shown that the structural shift from an agricultural/mercantile economy to an industrial economy brought a mass of urban wage earners into existence. These wage earners came to the urban-industrial centers with literally no means of survival, save their labor. Wage levels were just barely enough to keep them alive at the minimum level of consumption. Thus, in the event of an extraordinary circumstance, such as illness or death of a family member, the lack of any formal consumer credit institutions to handle their financial needs forced them to seek out the illegal money lender. The abuses arising out of this practice led to philanthropic attempts to eliminate the money lender through remedial loan societies and other forms of consumer lending agencies. Credit unions in the U.S. emerged along with this movement. The difference, however, was that credit union operations were based on the concept of mutual self-help rather than philanthropic forms of charity. Yet, it must be recalled that if it were not for Filene's funding of the

Credit Union National Extension Bureau (CUNEB) the credit union industry may never have reached maturity.

With organizational support from CUNEB and the Russell Sage Foundation, credit unions proliferated along the east coast. Nevertheless, credit unionism did not spread rapidly anywhere else in the United States. It was not until the catastrophic economic collapse caused by the Great Depression and the consequent passage of the Federal Credit Union Act in 1934 did the establishment of credit unions become widespread.

Throughout most of the post World War II era, credit unions enjoyed buoyant and relatively unhampered growth. The economy performed at unprecedented levels as national income, employment, and earnings grew significantly. As shown in the early chapters, federal credit unions were direct beneficiaries of the economic growth process, with members earning higher wage levels federal credit unions realized rapidly growing amounts of per member savings. Higher wage levels coupled with the increasing output of consumer goods in turn increased member demand for consumer credit. Furthermore, because of relative financial market stability and very little disintermediation, credit unions were able to assume a captive membership base. Given the interest rate margin between loans rates and deposit rates, credit unions were thus able to achieve substantial net income growth.

By the mid 1960s, the idealism of the credit union leadership led to attempts at establishing credit unions among the poor blacks, hispanics, and whites. These efforts were largely unsuccessful thereby indicating

that the historical juncture had been reached where credit unions could no longer be considered a financial haven for the poor and the "weak". It became clear that credit unions had become an institution which depended financially on the "middle class". Indeed, credit unions, as financial institutions, needed members with jobs because only these people possessed the funds to support credit union growth and vitality.

Correspondingly, there arose the practice of professional credit union management. The concept of altruistic voluntarism, people helping each other to achieve personal financial security began to yield to self-interest. The new breed of credit union professional had little contact with the membership at large and thus, took a more objective view toward members, such as a bank would toward its customers. Moreover, these new credit unionists generally welcomed the opportunity to grow, since growth meant more responsibility, larger size and higher salaries. Thus, the rise of the new management laid aside the concept of selfless volunteerism which Croteau believed was inherent in the practice of credit unionism.

During the 1970s, the list of economic problems grew rapidly. Economic growth slowed to a snails pace; real wages were falling; unemployment was on a secular rise; inflation reached unprecedented heights causing interest rate volatility to intensify. Financial market competition reached heightened levels causing disintermediation to become the "Achilles Heel" of financial depositories. These economic events illustrated quite clearly that, compared to their past, credit unions had become a fundamentally different institutions. Through an acceleration of

the trends which were already in process, a transformation occurred which essentially meant that the basic nature of credit union operations, in philosophy and in practice, had been dramatically altered.

The economic decline of the traditional manufacturing sectors during the 1970s and its culmination in the structural stagnation of the early 1980s literally shocked credit unions and their regulatory authorities into the realization that credit unions were not immune to the ebb and flow of economic change. In spite of the fact that credit unions were able to enjoy 25 years of growth on the basis of industrial-economic development, the historical juncture was reached wherein credit union economic viability had become dependent upon overall economic growth. The structural alterations that occurred throughout the American economy taught many credit unionists the importance of having a diversified basis of membership. To ensure credit union survival, credit union regulatory authorities were compelled to deregulate credit union dependence on the traditional common bond and to adopt and encourage a multi-group, business-like approach to credit union operations.

On the financial side, the extreme volatility of interest rates and the consequent phases of disintermediation made credit unions aware that members were no longer willing to exercise unconditional loyalty to the credit union. Indeed, members saw no reason to leave their funds in low paying credit union accounts as number of competitive product/service offerings gave members an option to their credit union account. Hence, the principle of maximizing returns from a given resource impacted credit unions as members learned to exercise optimal allocation of their personal

financial resources. To offset this, credit union regulatory authorities allowed credit unions to expand their array of products and services offered in an effort to retain member business.

Credit unions, in their own right, also displayed the transformation in their basic operational posture. Whereas Croteau argued credit unions had no economic goals other than the financial well-being of its membership, events during the late 1970s rendered his position historically untenable. As short term market rates reached the 12 percent limit that credit unions could charge on member loans, credit unions restructured their asset portfolios by drastically curtailing member loans in favor of relatively low risk, high return external investments. This occurred at a time when members were most in need of remedial loans to offset the impact of plant closings and layoffs. Clearly, credit unions were maximizing the returns from their assets by shifting away from member loans.

Another aspect to undergo fundamental change was the turning over to credit union management the sole responsibility of credit union operations. Credit union authorities have deregulated credit unions to such an extent that credit union management has become responsible for adjusting to the market driven changes that impact their credit unions. As a result, credit union management styles have adjusted to assume a greater degree of responsibility for their own decisions.

Conclusion

The aforementioned developments have clearly altered the structural nature of credit union operations. Credit unions no longer stand aloof from a general business posture since expansion and diversification of the membership base has become the key to institutional survival in today's rapidly changing economic environment. Consequently, members are treated as customers and the protection of the weak and concern over the latent abilities of the common man have been set aside for more the pragmatic concerns of growth and profitability. Volunteerism has been replaced by professional management and the latter is motivated by the practical aspects of competitive organizational efficiency.

The fact that credit union development has grown dependent upon increasing member wealth and affluence has placed emphasis firmly upon the multi-group credit union structure. To retain member business, credit unions have undergone a transformation in the structure of their assets and liabilities. This transformation has allowed them to satisfy member demand as well as to match the competitive product and service offerings of other financial service providers. Moreover, credit unions now strive to reach goals and objectives which are generally common to competitive firms, such as cost efficiency and the maximization of the return from a given resource. These goals and objectives do not necessarily support the economic aspirations of the economy of the household. Concerns over profitability have taken precedent over dedicated service to members for the sake of the member's financial well-being. Rather, members are viewed in terms of risk and potential earnings relative to the goals of the credit union rather than in a so-called democratic or humanistic manner.

Footnotes

(1) John T. Croteau, The Economics Of The Credit Union, (Wayne State University Press, 1963) p. xvii.

(2) Ibid., p. 1. The concept of profit is undergoing considerable change among credit union professionals. In Perceptions, Summer 1985, Sharon Curtis writes,

"For many years, the word profit was a 'dirty word.' Because credit unions are nonprofit organizations, it went against the grain of managers and board members to price services and set rates at levels that would allow funds to be set aside for what was perceived as being strictly for the benefit of the organization. In the pre-deregulation environment, this view of credit unions was the perceptual cornerstone of the credit union movement. Today, the strength of that cornerstone is still intact, but the structure it supports has been 'remodeled' so that we must change our view of what it means to be profitable."

(3) Ibid., p. 1.

(4) Ibid., p. 3.

APPENDICES

APPENDIX A

Financial Intermediation

In a market economy, the flow of funds between savers and borrowers occurs through the exchange or trading of financial market instruments, some of which are listed in Table 1.1. The accessibility to markets where financial instruments are traded, the relatively large size at which individual transactions are possible, and the relative costs involved in effecting small transactions all contribute to separating savers and borrowers from direct market contact. Consequently, financial market exchange occurs generally through a third party, a financial intermediary. An intermediary links savers, those who supply capital to financial markets, with investors, those who demand capital. Financial intermediaries primarily provide a means for the fluid movement of capital between savers and borrowers. Examples of financial intermediaries are listed below:

Commercial Banks	Investment Companies
Mutual Savings Banks	Stockbrokers
Savings and Loans Association	Finance Companies
Credit Unions	Leasing Companies
Insurance Companies	Pension Funds

Financial intermediaries function by issuing relatively low risk secondary securities and by holding relatively high risk primary securities. (See table A.1) The classic concept of a market as a meeting place for buyers and sellers engenders a vision of a middleman who brings the actual participants together so as to allow them to engage in exchange.

The instruments offered by those seeking credit are not generally those in which the bulk of the nonfinancial public is willing and able to hold. These instruments--notes, bonds, equity shares--lack one or more of the qualities sought by most savers, such as safety of principal, liquidity, convenience, or accessibility in readily divisible denominations. It is precisely these qualities that financial intermediaries are incorporated to offer. In recent years, intermediaries have not only offered these qualities to the nonfinancial public (households) but have offered them in increasingly diversified forms and at increasingly attractive rates of return.

Though less the case since the financial market deregulation of 1980, the principle difference among financial intermediaries centers on the types of securities they hold as assets and issue as liabilities.

TABLE A.1

<u>Financial Intermediary</u>	<u>Primary Security</u>	<u>Secondary Security</u>
Savings and Loan Assoc.	Mortgages	Savings Share
Mutual Funds	Stocks Bonds	Mutual Fund Shares
Life Insurance Companies	Stocks Bonds Mortgages	Life Insurance Policy
Credit Unions	Consumer Loans	Credit Union Shares
Commercial Banks	Commercial Loans Consumer Loans Mortgages	Demand Deposits Savings Deposits Deposit Certificates
Pension Funds	Stocks Bonds	Pension Fund Reserves

Financial intermediaries lend at one stratum of interest rates and borrow at a lower stratum. The difference between what they pay for funds

and what they charge borrowers is the return for their service. This includes a "marginal" return for bearing the risk of illiquidity. Because the financial instruments offered by those seeking long-term financing are not the type which the bulk of the nonfinancial public is generally willing to hold, financial intermediaries convert relatively short term funds (savings) into long term obligations (loans). These primary securities lack, for the most part, one or more of the qualities sought by savers

There is an element of risk inherent in this process which is expressed in a premium (profit) the financial intermediary earns as a result of the function it performs. In financial markets, this premium is generally referred to as the spread between interest-earning assets and interest-paying liabilities. Profit oriented financial institutions strive to maximize their spreads since growth capital as well as venture capital are to a large extent derived from profits.

APPENDIX B

Examples of Credit Union Growth

In 1909 St. Mary's Cooperative Credit Association became the first credit union in the United States. Shortly thereafter, the New Hampshire legislature passed a special act allowing the incorporation of St. Mary's Credit Association. In the same year, the Massachusetts Credit Union Act became law. Thereafter and until 1920, when Filene organized CUNEB, the movement virtually stagnated. The strides made by CUNEB and by local credit union leaders and members are reflected in the number of both credit unions and credit unions membership described in the previous section. During the period from 1920 until 1934, credit unions made considerable progress in terms of growth in the number of credit unions, in total membership and in reserves. As already noted, these early credit unions also suffered from the effects of economic conditions during the Depression. Against this broad historical and statistical backdrop constructed in the body of this dissertation, the following describes the founding and growth of some of the early credit unions. (1)

The most striking examples of credit union growth prior to 1934 occurred among the New England telephone workers, the employees of New York City, the United States postal clerks, the railroad workers, and among the members of the Brotherhood of Railway Clerks. This section addresses the progress of credit unions in these occupational groups. With the exception of the postal employees' credit union movement, the history of these credit unions is narrated within the context of the development of credit unions in Massachusetts and New York State, where the greatest progress was made during the infancy of the credit union movement.

Postal Credit Unions

The United States Post Office, one of the world's largest employers, provides one of the best illustrations of early credit union growth. Stable employment and membership in small, closely knit groups which made possible knowledge of all the social and financial affairs of members, characterized post office employment during this period. Stable, permanent employment and intimacy between employees were essential conditions for the growth of credit unions throughout the first sixty years of their existence in the United States.

Henry S. Dennison, one of the earliest supporters of the credit union movement in Massachusetts, became Director of Postal Service Relations shortly after World War I. Already familiar with a successful credit union among the employees of his own company, Dennison Manufacturing Company, he perceived the potential benefit of organizing a credit union for postal employees. (2)

With Dennison's approval and tactful encouragement, the first credit union was organized among the employees of the Brockton Post Office in 1923. Six were chartered a year later, and eighteen more organized at the end of 1924. At the end of 1930 no less than 245 postal credit unions were formed with a membership of 40,574. Assets reached nearly \$3,500,000 and loans grew to a total of \$15,234,889 with 125,384 borrowers. By the end of 1932, ten years after the first credit union was started in the postal system, there were 298 credit unions with a membership of 57,636 and assets

of over \$6 million. The following table details the development of Postal Credit Unions from 1923 to 1930:

TABLE B.1

Development of Postal Credit Unions, January 1923 to December 1930

DATE	Unions	Members	Assets	Borrowers	Loans
January 17, 1923	1	8	\$19	NONE	NONE
December 31, 1923	7	**	**	**	**
December 31, 1924	25	**	**	**	**
April 1, 1925	36	5,087	\$166,390	3,756	\$283,634
October 1, 1925	44	7,320	\$257,943	2,766	\$307,285
April 1, 1926	48	9,726	\$439,523	5,484	\$463,384
October 1, 1926	63	11,429	\$563,189	4,824	\$545,162
April 1, 1927	73	13,993	\$782,189	6,230	\$711,168
October 1, 1927	83	16,257	\$1,001,535	7,253	\$873,257
April 1, 1928	168	19,098	\$1,265,548	7,779	\$976,372
December 31, 1928	190	25,397	\$1,770,952	18,963	\$2,169,474
December 31, 1929	208	33,984	\$2,523,917	30,636	\$4,080,682
December 31, 1930	245	40,574	\$3,338,219	37,694	\$4,824,471

Source: Monthly Labor Review, October 1931.

** No data

In any study of early credit union movement, the credit unions of New York and Massachusetts are considered most representative of early credit union development. Throughout the entire period under review, a large proportion of individual credit unions and of total credit union membership were to be found in these two States. In addition, credit unions in these states provide an intermediate term perspective of credit union growth.

Credit Unions in Massachusetts

Massachusetts is unique in credit union annals in that the early cooperative credit movement was born and based in the State. Some of the earliest credit union pioneers, such as Pierre Jay, Roy Bergengren and Edward Filene lived in Boston, Massachusetts. CUNEB, for many years the focal point of promotional activity, operated out of Boston. On April 15, 1909 Massachusetts became the first state to pass a general statute for the incorporation of credit unions. With some modifications, most subsequent state credit union laws as well as the Federal Credit Act were modeled after the Massachusetts Credit Union Act.

St. Jean Baptiste, the first credit union in Massachusetts, was founded in the town of Lynn and began operations on October 7, 1910. Like many early credit unions, it began with the modest sum of \$85 as its capital. The credit union was housed in the church rectory, and all duties were assumed by volunteers. At the end of the first year of operation, the credit union had 105 members and a total of \$4,463 in paid-in shares and \$4,048 in loans.

The Industrial Credit Union, sponsored by the Women's Educational and Industrial Union of Boston, was established shortly thereafter. Its broad charter enabled the Industrial Credit Union to accept deposits from city residents and those working in the greater Boston area. Men and women of known honesty and industry were invited to become members. In order to join the credit union, a person had to pay a fifty-cent admission fee and subscribe to at least one five-dollar share, payable in small weekly

installments. The Industrial Credit Union remained in business for only ten years. During that time, it failed to collect only \$292.43 of a total of \$330,000 lent, a record which indicated that insistence on knowing the character of members kept loan delinquency and defaults under control.

Up through the 1920s, credit union growth was confined mainly to Massachusetts albeit they continued to develop slowly elsewhere. Only seventeen credit unions were organized during 1911, and they served only 1,623 members. In total, these credit unions had assets of only \$25,942, and shares averaged about \$12 per member. Credit union development was even slower in 1912, as only nine credit unions were organized, bringing the total number of credit unions to 26, with total assets of \$91,510. By 1913, 34 credit unions were operating with a combined membership of 4,577 and assets totaling \$180,923.

The employees of the New England Telephone Company of Massachusetts were also pioneers in the movement. Their first credit union was organized in 1917 with an initial capital of \$4.50. By the end of its first year, membership in the credit union had grown to five hundred, and assets totalled \$7,000. By 1930, the membership grew to 7,027 and assets reached \$796,000. The organization of credit unions affiliated with these telephone workers spread to Rhode Island, New Hampshire, and Maine with total membership rolls reaching 15,000 and assets of \$1,600,000.

Railway company employees also organized several credit unions. By 1929, twenty-five credit unions were established among Rock Island employees, and ten credit unions were established among workers of the

Chesapeake and Ohio railroad. The Brotherhood of Railway Clerks also were quite active in organizing credit unions. By 1929 there were seventy credit unions among the various lodges. Several credit unions were also organized in locals of the Machinist's Union and the Brotherhood of Trainmen.

Data gathered concerning the state of credit union development in Massachusetts show that the number of credit unions increased at an average of 16.6 percent per year between 1911 and 1933. Membership in credit unions increased 24.3 percent per year over that period. Asset savings, and loan growth were strong throughout this period, as they increased 39.5 percent, 39 percent, and 40.1 percent respectively. Credit unions averaged about 350 members each, with average asset level of \$41,366. Members on average saved \$107 yearly and borrowed \$93 yearly. The assets of these credit unions consisted almost entirely of member savings. The average savings/asset ratio was 92 percent; loans outstanding averaged 79.2 percent of total assets and 86.2 percent of savings during this period. The following table details the quantitative nature of aggregate credit union development in Massachusetts.

TABLE B.2

Credit Union Development in Massachusetts
(dollar items in thousands)

Year	Number of Unions	Number of Members	Total Outstd Loans	Total Member Savings	Total Union Assets
1911	17	**	\$19	\$25	\$26
1912	26	**	\$68	\$86	\$91
1913	34	**	\$146	\$170	\$180
1914	50	6,149	\$224	\$256	\$269
1915	47	7,846	\$362	\$395	\$418
1916	53	11,418	\$652	\$764	\$808
1917	56	14,821	\$993	\$1,154	\$1,235
1918	59	17,636	\$1,555	\$1,853	\$1,962
1919	60	22,987	\$2,295	\$2,611	\$2,769
1920	65	29,494	\$3,323	\$3,723	\$3,966
1921	82	32,226	\$3,314	\$3,718	\$4,047
1922	86	37,797	\$3,832	\$4,610	\$5,021
1923	90	44,969	\$4,766	\$5,747	\$6,297
1924	89	**	\$5,706	\$6,783	\$7,460
1925	86	55,218	\$6,749	\$7,848	\$8,669
1926	205	74,797	\$9,022	\$10,100	\$10,999
1927	279	88,710	\$10,738	\$12,303	\$13,444
1928	296	98,402	\$11,785	\$13,830	\$15,137
1929	299	**	\$12,628	\$14,557	\$16,153
1930	309	**	\$11,861	\$13,052	\$14,608
1931	302	**	\$11,043	\$12,210	\$13,874
1932	285	102,423	\$9,492	\$10,865	\$12,521
1933	282	**	\$8,864	\$10,346	\$12,023

Source: Monthly Labor Review, September 1934.

** No data

Unlike credit unions in other states, credit unions in Massachusetts did not follow the general practice among credit unions of confining loans to remedial loans. Small consumption loans were made by the average credit union in Massachusetts; however, some Massachusetts credit unions also invested large amounts in real estate mortgages as well. Accordingly, the dollar amount of the average credit union loan in Massachusetts was much larger than in any other State.

Credit Unions in New York

Besides Massachusetts, the most vigorous early credit union organization and growth occurred in the State of New York, which enacted the second general credit union law in 1913. In January 1914, the first credit union in New York was organized by employees of Bing and Bing, Inc. By 1915, there were seventeen credit unions, with 2,402 members operating in New York. In general, however, credit unions in the State of New York were of the open membership type, (i.e., the common bond signifies nothing more than membership in the credit union). Indeed, the experience in New York demonstrated that the cooperative consumer credit movement during these early years was put to the severest test when it was centered in groups without any other unifying link. Of the 150 credit unions operating in the state of New York State at the end of 1935, 53 were of the open variety, and of these, 44 were in New York City.

By 1928, 73 of the 118 credit unions, or 62 percent, in New York State, were located in the City of New York. Moreover, 74 percent of total statewide credit union membership was concentrated in the City of New York. The following table details credit union development in the State of New York:

TABLE B.3

Credit Union Development in New York
(dollar items in thousands)

Year	Number of Unions	Number of Members	Total Outstd Loans	Total Member Savings	Total Union Assets
1915	17	2,402	\$50	\$58	**
1916	29	5,941	\$151	\$182	\$210
1917	39	9,404	\$320	\$386	\$465
1918	41	9,760	\$424	\$498	\$568
1919	49	14,061	\$995	\$1,000	\$1,154
1920	70	22,321	\$1,961	\$2,044	\$2,304
1921	85	33,480	\$3,905	\$3,878	\$4,445
1922	101	45,244	\$6,020	\$6,039	\$6,837
1923	106	52,234	\$7,584	\$7,442	\$8,506
1924	114	64,001	\$9,293	\$9,243	\$10,550
1925	120	68,067	\$10,243	\$10,512	\$12,094
1926	116	67,119	\$10,736	\$10,729	\$12,530
1927	113	71,356	\$11,257	\$10,988	\$13,043
1928	118	75,040	\$11,643	\$11,287	\$13,387
1929	**	**	**	**	**
1930	**	**	**	**	**
1931	**	**	**	**	**
1932	113	50,719	\$5,229	\$5,655	\$7,564
1933	140	55,117	\$4,852	\$5,523	\$7,290

Source: Monthly Labor Review, October 1935.

** No data

As can be seen in Table B.3, New York credit unions suffered a tremendous set back during the Depression. Between 1928 and 1932, the number of credit unions declined by 4.2 percent; membership dropped 32.4 percent; outstanding loans, member savings, and total assets fell 55.1, 49.9, and 43.5 percent, respectively. As a percent of total assets, loans outstanding dropped from 87 percent to 69.1 percent, indicating the difficulty in maintaining the loan business during the Depression.

Footnotes

(1) The following material is derived mainly from M.R. Neifield, Cooperative Consumer Credit, (Harper & Brothers, 1936).

(2) Employees of the post office were nearly always involved with petty loan sharks, which were fellow employees of the postal system. When postal workers needed small loans they generally borrowed from one another. As a result, many workers took advantage of this state for their own profit. Postal credit unions were organized with a view to ending this practice. See "Postal Employees Credit Unions", United States Post Office, February 1933.

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