The incentives of regulators: Evidence from banking

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In a paper on taxicab regulation, Ross Eckert (1973) argued that politically appointed regulatory commission, who are in office for relatively short terms, have incentives which differ from those of career civil service officials in similar positions. Differing constraints on utility maximization for the two types of regulators imply that 'commissioners will more often choose to restrict entry of new firms . . . to make their duties less onerous. That is, monopoly or monopolistic restrictions should be more common in markets regulated by commissions than in those regulated by bureaucratic agencies' (p. 87). In this note we test this implication with data on the chartering of new commercial banks. In addition, we provide evidence on: (1) the effect on entry of competing state and federal chartering agencies, and (2) the effects of interest group representation on politically appointed regulatory boards.

Political vs. bureaucratic bank supervision

In every state there is statutory authority by which an official agency, henceforth called the bank supervisors, can issue charters for new banks. In 26 states the supervisors can be usefully viewed as politically appointed officials with the power to approve charters, while in the remainder they are categorized as career employees. According to Eckert's theory, career supervisors will be more liberal in allowing entry than will political supervisors.

We use multiple regression analysis to test the influence of political supervision on bank entry. The dependent variable is STENTRY, the number of new state bank charters issued per million population over 1972-76. Three independent variables are included. POLAPROV is a dummy variable equal to unity in states where charter applications are approved by a politically appointed supervisory board. It is zero in states with civil service boards. The two remaining independent variables standardize for influences frequently alleged to be important. NIEQUITY is the average...
return on bank equity in the state over 1972-76, and POPGRO is the percentage rate of population growth in the state, 1967-76. The number of charter applications per state is not used as an independent variable, since it would be determined simultaneously with entry in a fully specified system.3

The entry rate of new state-chartered banks is given by:

\[
STENTRY = -18.66 + 1.57 \text{ NIEQUITY} + 27.65 \text{ POPGRO} \\
+ 5.92 \text{ POLAPROV}, \quad R^2 = .39 .
\]

(Figures in parentheses are t-statistics.) All estimated coefficients are significant at the 1-percent level. Those for NIEQUITY and POPGRO carry the theoretically expected signs, but the positive coefficient of POLAPROV provides evidence that Eckert's hypothesis on regulator behavior is unsupported in banking.4

The dual regulatory system

Banks are characterized by a system of 'dual regulation,' in which a charter applicant may obtain permission to enter a market from either federal or state authorities (Scott, 1979). National bank charters, issued by the U.S. Comptroller of the Currency, are close substitutes for state charters. The former are issued under standards which are likely to be uniform across states while, as has been shown above, the latter are likely to depend on the political nature of the state supervisory board. Niskanen (1979) has claimed that regulation is more likely to result in cartelization of an industry if approval by one regulatory board is the sole possible means of new entry. He asserts that competition among regulatory boards, however, will ensure that the desirable effects of regulation (e.g., competent bank examination) endure, while the undesirable effects (e.g., entry limitation) vanish. He writes:

The private purpose of much banking regulation has been to restrict entry and maintain cartel prices. Charter mongering by banking commissions is most likely to eliminate just those regulations that no longer serve a public purpose by undermining the various restrictions on entry that only serve the purpose of existing cartels (1979: 48).

We now attempt to provide evidence on whether the option of a national bank charter reduces the restrictive effects on entry which might result from state board practices. Equation (2) explains the total entry rate of new banks (state plus national) per million population, TOTENTRY. If national