Credit Unions: Theory, Empirical Evidence and Public Regulation: Discussion
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demand and supply of credit union shares, loans, and non-loan investments simultaneously. By so doing, he provides useful insights into credit union behavior. To my knowledge, his finding that credit unions use their non-loan assets as a buffer, either to finance share outflows or extraordinary loan demands or to absorb temporarily excessive inflows of funds, has not been previously documented. In addition, he has effectively documented the relationships that exist between loan flows, loan rates, dividend rates, and share flows as credit unions attempt to (1) accommodate loan demand by attracting additional funds and, (2) pass on additional earnings to their savers. Thus, his paper, along with the others presented here, is a valuable addition to credit union literature.

REFERENCES

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DISCUSSION

CARL M. GAMBS*: The paper by Harold Black and Robert Dugger provides an excellent survey of the current state of credit union industry—the best one that I am aware of. I would, however, have preferred that the paper deal more with some of the issues raised in its concluding section. While the sharp slowdown in credit union growth that occurred in the last two years was primarily a result of developments in financial markets, it may well be that recent legislative and regulatory developments mean that credit unions will never again resume the rapid growth that had come to characterize them. I think that the paper would have been much more valuable if it had spent more time analyzing the likely effect of the Depository Institutions Deregulation and Monetary Control Act of 1980, as well as the effects of other technological and regulatory developments.

Since the paper is primarily a survey of the credit union industry, I would be remiss if I did not note what seems to me to be an important omission. The paper does not discuss the increasingly important role of the corporate central credit unions. These institutions today provide a surprisingly sophisticated and efficient nationwide system for managing credit union liquidity and for channeling funds to credit unions with liquidity needs. One rather odd aspect of this situation is that there is a great deal of rivalry between these institutions and the NCUA's Central Liquidity Facility, as the two are alternative sources of borrowed funds for credit unions. It may well be that the growth of corporate centrals will leave the CLF with only a minor role to play in supplying funds to credit unions.

The very existence of credit unions presents problems for the economist's standard way of thinking. Individuals are supposed to maximize utility and firms are supposed to maximize profits, but in credit unions we have an entity that

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looks like a firm, but which does not appear to be a profit maximizer. I think that there is ample evidence that Frank Navratil is correct when he states that: "While members act in an economically rational fashion, there is some evidence that credit unions themselves do not."

One way to approach credit unions is to think of them as cooperative organizations which allow members to obtain higher returns on savings and lower rates on borrowings. This approach is essentially what seems to be behind the objective function used by Smith, Cargill, and Meyer.

This approach to credit unions may well describe the foundations of many of these organizations. However, it must be recognized that the term "credit union movement" that is still prevalent in the industry has been more than a slogan. The formation of credit unions originally had a substantial ideological motivation. Indeed, credit union mailings to members still sometimes seem to discuss banks with about the same degree of affection that the John Birch Society has for the Communist Party.

The future of the credit union industry (movement?) will, in large part, depend on whether credit unions can attract the quality of management necessary for growth and survival in an increasingly competitive and complex financial system. When I talk to people knowledgeable about credit unions, there seems to be general agreement that credit union managements are far less financially sophisticated—and some would say less able—than the managements of competitors. This is not surprising—small institutions don't pay high salaries—particularly when they regard themselves as part of a movement.

Credit unions have been able to compete effectively in spite of their less sophisticated managements because they were relatively simple entities enjoying the host of competitive advantages that has been alluded to in the three papers presented here. However, credit unions are now becoming more complicated entities offering what are essentially checking accounts and in some cases even getting into the mortgage business. Furthermore, as Black and Dugger have noted, most of these advantages are disappearing.

I would like to add two more disappearing advantages to their list. In most parts of the country, share drafts have not had to compete with NOW accounts. As a result, share drafts have been able to obtain a reasonable part of the checking account business while paying what turns out to typically be only a 2.5–3.0 percent effective interest rate. When credit unions are faced with NOW account competition paying a true five percent (or higher) rate of return, they will be forced by competition to change their interest computation methods and thus will find themselves with a substantially higher cost of funds.

Credit unions have traditionally been able to hold down loan losses because of the fact that there was a common bond. The loan committee had access to information about the borrower not available to outside lenders, and the borrower was less likely to default on a loan that he thought of as being made to his colleagues. In addition, there are persistent rumors that credit unions with a true common bond were able to use tactics to collect defaulted loans that would not be available to other lenders and that, indeed, would be clearly illegal today. All of these factors disappear when a credit union becomes relatively large and impersonal.

Since my complaints about the paper are more on sins of omission than commission, let me note a few of the questions that, if they could be answered, would give us important insights into the future of credit unions:

1. Will credit unions be able and willing to provide rewards sufficient to attract the quality of management necessary for survival?
2. Can credit unions effectively handle the vast amount of consumer legislation—Truth in Lending, Fair Credit Billing, etc.? (A study of the impact that these regulations have had on credit unions thus far would be useful.)
3. Will credit union members be satisfied with truncated share drafts drawn on distant banks in a world where there will be NOW account competition and where float pricing may lead to discrimination against instruments drawn on out-of-territory points? If not, the cost of handling share drafts will rise substantially.
4. Is there still such a thing as the "credit union movement?" Do members retain enough loyalty to continue dealing with a credit union if it no longer offers higher deposit rates or lower loan rates?

DISCUSSION

MARK J. FLANNERY*: The papers by Navratil and Black and Dugger serve as an excellent backdrop for the theoretical model of Smith, Cargill, and Meyer (SCM). The credit union (CU) sector's extraordinary growth between 1965 and 1978 resulted primarily from the relatively lax deposit (share) rate ceilings imposed by their Federal regulator. Credit union shares and other deposit types are close substitutes, and consumers proved highly responsive to the explicit interest rate differential. Navratil's econometric estimates document this cross elasticity. Black and Dugger's assessment of CU's current status further emphasizes their competition with other intermediaries. CU have long possessed a comparative advantage in providing depositors (members) with geographic convenience and payroll deduction plans. In the future, EFT innovations and the increased importance of explicit deposit rate competition among intermediaries will tend to erode these historic advantages, and the CU sector should shrink relative to its competitors.

The SCM paper develops an innovative micro model of the CU as a particular type of intermediary. The paper's primary shortcoming is its failure to incorporate some important theoretical and empirical results available for the closely related cases of bank and thrift institution retail competition. I emphasize this at the outset because I believe CU are financial firms competing with and in most respects similar to other depository intermediaries. Prior CU researchers have too often viewed credit union firms as somehow unique (perhaps because the credit union "movement" was initially social and political as much as financial), and I feel this perspective has interfered with good economic analysis.

SCM's primary conceptual contribution is an objective function that allows

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