

# TEXAS

## BUSINESS REVIEW

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College and Graduate School of Business, University of Texas at Austin

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### The Texas Economy: The Environment For Financial Institutions

The 1980s have witnessed a revolution of the financial industry in Texas. From a conservative but thriving industry in 1980, financial institutions soared through deregulation and the real estate boom and disintegrated in the wake of excess banking capacity and the real estate crash. By the end of the decade, the fragments have for the most part been sold to out-of-state investors. Whether Texas will ever reclaim a significant independence for its financial institutions is highly uncertain.

The statistics are indisputable. Of the nearly 1,000 banks that have failed since 1982, 333 are in Texas. Of the \$21.6 billion of FDIC cash assistance required from 1984 through 1988, more than \$9 billion has been spent on Texas banks. The S & L losses in Texas are staggering and to date, unquantifiable.

Why was Texas more vulnerable than the rest of the nation to extreme instability in its financial institutions?

*Depression in the oil markets.* While the rest of the nation has enjoyed the longest peacetime expansion since the 1920s, the energy economy has experienced a depression. More than half of the bank failures since 1982 have occurred in Texas, Colorado, Oklahoma, and Louisiana. Oil prices tell far less of the story than real estate, however. The major declines in oil prices occurred before and after the banking crisis did. Deregulation occurred in 1982, after oil prices had dropped below \$30 per barrel. Most of the bad real estate loans were put on the books in

1983, 1984, and 1985, before prices dropped again in 1986. The steep oil price decline in 1986 meant that some borrowers could not cover the real estate loans that had already gone bad.

*High real interest rates.* Banks earn profits on the spread between borrowing and lending rates. Borrowing rates are determined nationwide by monetary policy, while lending opportunities are determined by local conditions. High real interest rates have a disproportionate impact on depressed areas. If Texas had been a nation and could have run its own monetary policy, it would have allowed higher monetary growth and prevented the deflation in asset values. It could also have lowered the cost of funds to the banks.

*Texas banking laws.* Until 1987, Texas law did not allow for any material branch banking. At the peak in 1986, Texas had 1,991 banks, fully 14.5 percent of the U.S. total. This posed an excess burden of regulatory costs, from the perspective of both banks and regulators. Ironically, the law that was designed to keep banking in local communities had the effect of driving it out of the state.

*S & L deregulation.* Compounding the problem for banks was S & L deregulation. Growing numbers of institutions were able to use insured deposits to finance high-risk commercial, acquisition, and construction loans. Thrift regulators considered brokered money to be an acceptable means to grow out of the problems caused by low interest rate spreads. The increase in deposit insurance coverage from \$40,000 to \$100,000 further accelerated the growth process. Unlike banks, Texas thrifts were allowed to branch and could grow considerably faster.

*Disparity between entry and exit.* A regulated industry that is easy to enter but has no graceful way to exit is a prescription for predatory behavior. In such industries, profit margins will be squeezed until excess capacity is ultimately eliminated. On the loan side, too many institutions were chasing too few good loans. On the deposit side, interest expense was 20 to 30 basis points higher for Texas banks than for nonmoney center U.S. banks during the period from 1984 to 1986. This difference existed before the time of the "Texas premium," when the extent of problem loans in Texas was recognized by investors who then demanded higher rates on their certificates of deposit.

*Fraud.* Fraud is the flip side of Texas optimism. A project that might have been perceived skeptically in the rest of the nation was viewed in Texas as bankable. The massive number of institutions worked against exposing fraud, as regulatory due process was far more time consuming than loan approval to affiliated parties. Even in circumstances involving fraud, Texas' comparatively generous usury and deceptive trade practice laws have led to a multitude of lender liability suits by borrowers.

The magnitude of the damage to financial institutions in Texas is demonstrated by the recent history of the largest institutions. Of the ten largest Texas financial institutions in 1980, each of which was then independent of out-of-state control, all but three have been sold to out-of-state groups, and two of those three have been assisted by the FDIC (see table below).

While Texas banks are being combined and acquired by out-of-state interests, the savings and loan industry is in the midst of a much-needed consolidation. Whether the home loan industry has any continuing reason to exist separately is an unresolved issue. Increased securitization of mortgage loans means that raising mortgage funds will be done in the capital markets rather than in the thrift office. Mortgage servicing is already a highly computerized operation provided on a large scale by specialized companies. Sufficient capacity exists in other financial institutions to handle all other real estate loans. The large number of branch offices in Texas enhances consumer convenience but escalates building, personnel, and security costs. Currently, an S & L charter offers few advantages compared to a bank charter. The

### The Largest Financial Institutions in Texas, 1980-1989

Institution	Ownership transactions, 1984-1989
First International (InterFirst Corporation)	Merged with RepublicBank Corp. in 1987 to form First RepublicBank Corp.; assisted in 1988 by FDIC with infusion of \$1 billion; failed in 1988; banking assets sold to NCNB Corp., North Carolina
First City Bancorporation of Texas, Inc.	Assisted by FDIC in 1988 with infusion of \$1 billion; banking operations reorganized under A. Robert Abboud, Chicago, whose group raised \$500 million
Republic of Texas Corporation (RepublicBank Corporation)	Merged with InterFirst in 1987 to form First RepublicBank Corp.; assisted in 1988 by FDIC with infusion of \$1 billion; failed in 1988; banking assets sold to NCNB Corp., North Carolina
Texas Commerce Bancshares, Inc.	Sold in 1987 to Chemical Banking Corp., New York
Mercantile Texas Corporation	Merged with Southwest Bancshares in 1984 to form MCorp; failed in 1989; banking assets sold to Banc One Corp., Ohio
Allied Bancshares, Inc.	Sold in 1987 to First Interstate Bancorp, California
Southwest Bancshares, Inc.	Merged with Mercantile Texas Corp. in 1984 to form MCorp; failed in 1989; banking assets sold to Banc One Corp., Ohio
Texas American Bancshares, Inc. Cullen/Frost Bankers, Inc.	Failed in 1989; assets sold to a group led by Ronald G. Steinhart, Texas Currently operating profitably without assistance
National Bancshares Corporation of Texas	Assistance by FDIC in process

## Employment and Unemployment Rate by Metropolitan Area

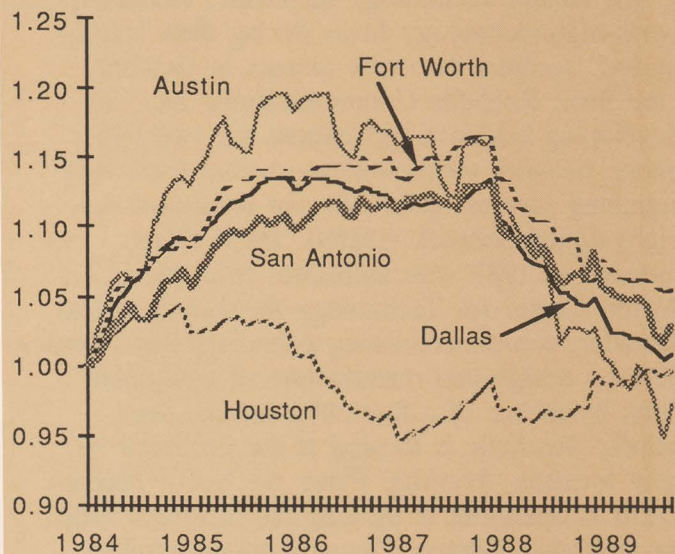
Area	Total nonagricultural employment (thousands)			Total employment (thousands)			Unemployment rate
	Sept. 1989	Sept. 1988	Percentage change	Sept. 1989	Sept. 1988	Percentage change	Sept. 1989
Abilene	49.6	49.6	0.0	50.1	50.8	-1.4	6.0
Amarillo	76.7	77.3	-0.8	92.7	94.2	-1.6	5.7
Austin	355.1	354.3	0.2	399.5	404.2	-1.2	5.2
Beaumont-Port Arthur	135.2	132.2	2.3	148.8	147.2	1.1	7.9
Brazoria	61.2	59.4	3.0	78.6	77.1	2.0	6.5
Brownsville-Harlingen	69.8	69.0	1.2	87.2	86.4	0.9	11.3
Bryan-College Station	51.2	49.2	4.1	57.6	55.9	3.0	3.8
Corpus Christi	127.3	125.0	1.8	144.7	143.5	0.8	7.7
Dallas	1,356.4	1,349.5	0.5	1,367.4	1,384.3	-1.2	5.2
El Paso	199.7	195.6	2.1	221.8	220.4	0.6	9.7
Fort Worth-Arlington	538.0	530.5	1.4	648.9	650.5	-0.3	5.4
Galveston-Texas City	71.8	71.4	0.6	97.6	98.8	-1.2	7.1
Houston	1,480.0	1,436.9	3.0	1,549.0	1,520.4	1.9	5.6
Killeen-Temple	72.7	72.0	1.0	89.3	88.7	0.7	6.7
Laredo	41.0	38.6	6.2	43.9	41.8	5.0	10.4
Longview-Marshall	65.5	66.6	-1.7	72.7	73.6	1.2	7.9
Lubbock	96.2	94.0	2.3	109.5	108.8	0.6	4.5
McAllen-Edinburg-Mission	95.5	93.5	2.1	125.7	124.6	0.9	17.1
Midland	43.9	44.9	-2.2	45.8	46.9	-2.4	5.8
Odessa	42.3	43.2	-2.1	47.5	49.3	-3.7	7.8
San Angelo	36.0	36.5	-1.4	41.9	42.8	-2.1	5.8
San Antonio	506.3	501.4	1.0	559.0	563.3	-0.8	7.0
Sherman-Denison	36.8	37.5	-1.9	44.8	45.9	-2.4	5.5
Texarkana	46.5	44.9	3.6	54.0	52.7	2.5	6.1
Tyler	61.1	60.3	1.3	69.2	68.9	4.4	6.9
Victoria	28.0	27.3	2.6	34.3	33.9	1.2	5.8
Waco	80.1	79.5	0.8	87.0	87.3	-0.3	5.3
Wichita Falls	50.4	51.0	-1.2	53.1	54.3	-0.2	5.7
Total Texas	6,808.1	6,682.3	1.9	7,744.6	7,749.5	-0.1	6.3
Total United States	109,453.0	106,601.0	2.7	119,502.0	117,066.0	2.1	5.0

Note: Data are not seasonally adjusted. Figures for 1988 have undergone a major revision; previously published 1988 figures should no longer be used. Revised figures are available upon request. All 1989 figures are subject to revision, with the exception of Texas and U. S. total employment.

Sources: Texas Employment Commission and U.S. Department of Labor, Bureau of Labor Statistics.

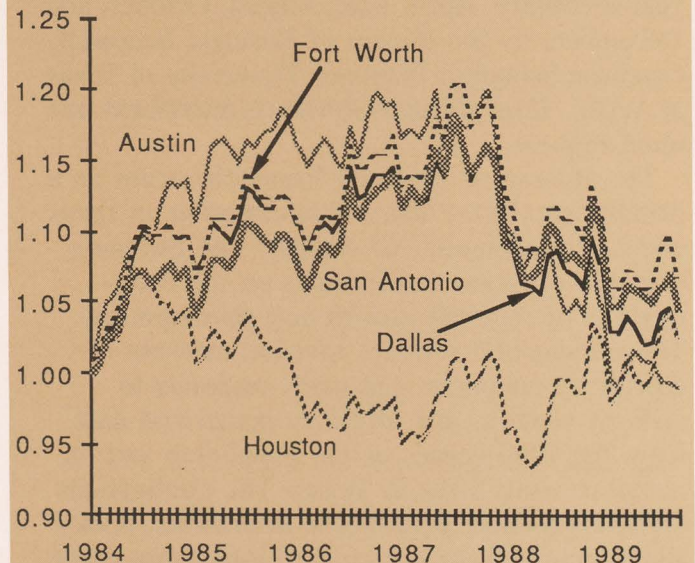
### Nonagricultural Employment in Five Largest Texas Metropolitan Areas

(January 1984=1.00)



### Total Employment in Five Largest Texas Metropolitan Areas

(January 1984=1.00)



disadvantages of an S & L charter include new administrative fees, surcharges on deposit insurance, and higher costs of borrowing from the regulators. We are likely to see more acquisitions like the recent purchase of the banking assets of failed University Savings by NCNB-Texas.

Adding to the complexity are regulatory and judicial issues, which will take years to resolve. Among the issues with greatest potential dollar impact are the following:

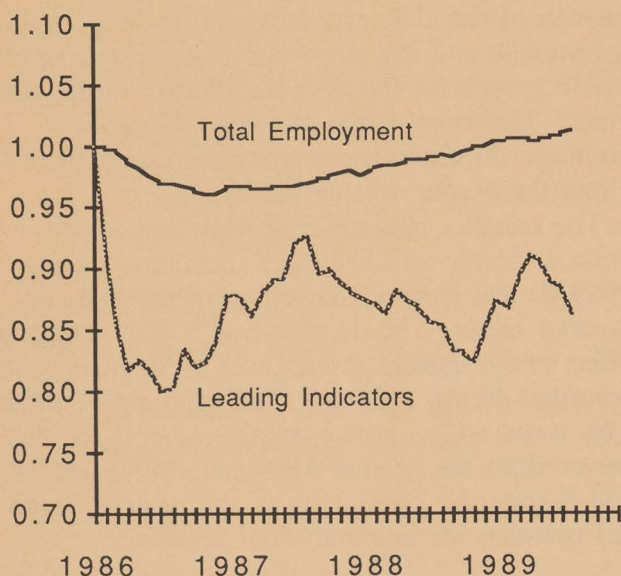
- (1) Will judicial decisions require that the FDIC compensate shareholders of holding company banks that were taken over but were insolvent only because they held bad debt from affiliated banks or their holding company?
- (2) Will the courts compensate bondholders of insolvent holding companies where the banks were taken over by the FDIC, leaving the debt to the holding company?
- (3) Will there be a reopening of some the 179 S & L "Southwest Plan" transactions that were excessively generous to buyers before the new financial institution legislation was in place?

- (4) Will the new capital requirements for savings associations allow them to be viable competitors in the financial markets of the 1990s?
- (5) Will recent changes in the market perception of junk bonds and leveraged buyout risks favor banks as the traditional means of financing, such that interest rate spreads and profitability rise?

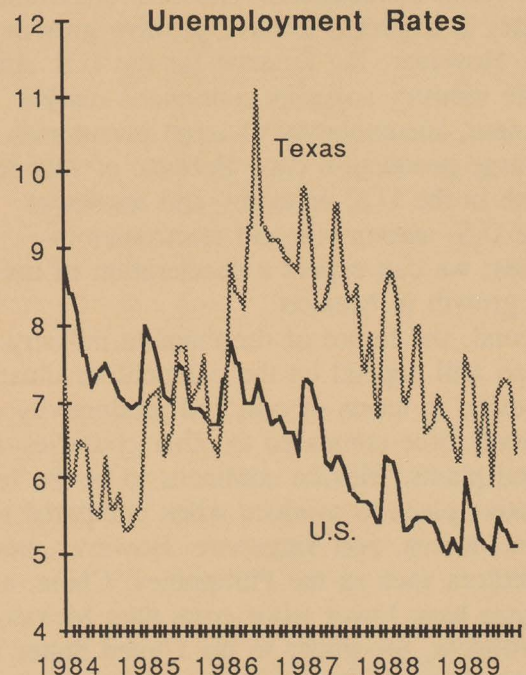
In the context of worldwide banking, where nine of the ten largest banks are Japanese, what should have happened in the United States was a consolidation of financial services, not a splintering of them. This consolidation will inevitably occur, because of large economies of scale in financial services and the increasing need for those services on a global scale. Banks are certain to be survivors among the various financial service providers. It is unfortunate that Texas-owned banks, at least for the immediate future, have missed the opportunity to compete in this worldwide arena.

— Carol T. F. Bennett, Ph.D.  
Price Waterhouse  
Houston


**Texas Index of Leading Economic Indicators**  
(January 1984=1.00)



**Texas and U.S. Unemployment Rates**



Source: U.S. Bureau of Labor Statistics.



## The Future of the Maquila Industry in Mexico

Several elements play an important role in determining the future of the maquila industry, which has evidenced such dramatic growth throughout the 1980s. The first of those elements is the growth of the U.S. economy, particularly of the electronic and automobile industries, the two most important sectors represented in the maquila industry. The second key element is the capacity of Mexico to sustain its competitive labor situation with respect to the Asian countries in which in-bond plants also operate. Third, the slowdown or continuous growth of the Mexican maquilas will depend on the economic performance of Mexico, particularly its success in maintaining the stability of the country, keeping inflation down, and supplying the infrastructure needed in the communities along the border with the United States.

The near-term transition of the U.S. economy to substantially slower real domestic economic activity can be expected to affect maquila growth adversely. Predictions from economists suggest that the easing of credit conditions by the Federal Reserve will stimulate investment and consumer expenditure for big ticket items, mitigating the decline in domestic demand that could result in recession. The U.S. electronics industry is expected to have positive growth rates. However, the forecast for the U.S. automobile industry suggests continuous market weakness, accumulation of large inventories, and large production cuts. Because of slower growth in the U.S. economy and weakness in the U.S. automobile and electronics industries, we can expect a deceleration of maquila growth in Mexico.

Second, the future of the maquila industry in Mexico will depend on the competitive situation of Mexico in terms of cost and productivity of the labor force compared to other countries with in-bond plants. Mexico continues to be the least expensive place to produce when compared to Taiwan, Korea, and Singapore. However, new competitors such as the Philippines, China, and Malaysia have lower labor costs than Mexico. Nevertheless, proximity to the United States is a strong factor in favor of Mexico.

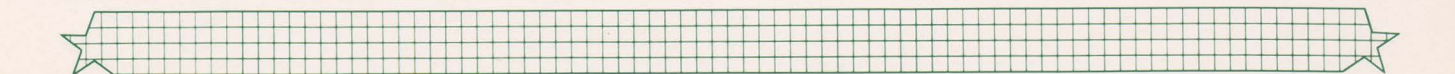
The economic outlook for Mexico is optimistic. The government extended the Solidarity Pact through the end of March 1990. This extension

continued the one-peso-per-day depreciation of the exchange rate and the freeze on most controlled prices. Wage control continues, although a 6 percent revision was allowed in July. Agreement on the external debt reduction and a near guarantee of a bridge loan have given credibility to the pact and have boosted expectations about economic performance in the medium term. Foreign investment is expected to play a key role during this administration, increasing almost twofold from \$2.72 billion in 1989 to \$5.4 billion in 1994.

Labor costs in dollar terms are expected to rise if inflation and minimum wages increase and if the peso rises against the dollar. Economists predict that there will be moderate average inflation of 19.8 percent at the end of 1989 and 15.3 percent at the end of 1990. These are significantly lower rates than the 131.8 percent in 1987 and 114.2 percent in 1988, although still higher than the targeted rate of 5 percent. A continuing devaluation of the peso is likely, but at a much slower rate. The devaluation rate was 148.55 percent and 138.2 percent during 1986 and 1987; it will continue to average 16 percent at the end of this year and 13 percent for 1990. No further increases in minimum wages are expected for the rest of 1989, and a modest increase is expected in 1990. All these changes will mean that salaries will be somewhat higher than they have been, the devaluation not having fully compensated for increases in the minimum wage and inflation. Higher wages in dollar terms and the slower growth of the U.S. economy, particularly in the automobile and the electronic industries, suggest stable growth for the maquila industry in the year ahead. However, if the already serious shortcomings of infrastructure worsen, maquila growth along the border will definitely slow.

The maquila industry's deceleration results from a slowdown of the U.S. economy during 1989-90 and from a weakening of the U.S. industrial sector. The deceleration is also a lagged effect of the significant increases in Mexican costs recorded during 1988 and the beginning of 1989. This trend will continue despite support for this sector from the present Mexican administration and despite the persistence of the wage differential between Mexico and other countries.

— *Elsie Echeverri-Carroll*  
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The Bureau of Business Research serves as a primary source for data and information on Texas and on the dynamics of change. The Bureau's research program concentrates on the determinants of regional growth and development. The information services division answers inquiries by telephone and mail, responds to walk-in visitors, and offers computerized data from the 1980 census of the population and on manufacturing firms in Texas. The publications division produces periodicals, directories, books, and monographs on a variety of topics that shape the development of the Texas economy.



## Announcements

The Austin Technology Incubator, which supports high-technology firms during their startup period, accepted two new tenants in October. One firm, Rochelle Communications Inc., is developing business applications for two telephone network technologies—custom local area signaling services (CLASS) and integrated services digital network (ISDN). DTM Corp., founded in 1987 with assistance from the U.T.-Austin Center for Technology Development and Transfer, is commercializing technology that allows desktop design and manufacture of equipment parts by means of a three-dimensional laser printer. Rochelle is located at the incubator's new location, Hyridge Place on North Mopac; DTM is operating in the original incubator facility at Braker Center. The new phone number for ATI is 794-9994.