The Changing Fortunes of Bank Economists

By Albert E. DePrince, Jr. and William F. Ford*

From World War II until the mid-1980s, business economists enjoyed an era of expanding job opportunities and high visibility in the banking industry. Since then, about one-third of America's top bank officer positions, once held by economists, have disappeared. And the visibility and prestige of the Chief Economist's job has clearly diminished. This article first documents and then analyzes the driving forces behind these changes in the fortunes of bank economists. It closes on a positive note by suggesting a new career path that may enable younger economists to rise once again to top positions in the banking industry.

IN JANUARY of 1991, *Forbes* magazine ran a major article entitled "Dreary Days in the Dismal Science."[1] It began by describing the unfortunate experience of a senior bank economist formerly employed by Chicago's Continental Bank. He became unemployed, at the age of fifty-two, after his bank decided to reduce their economics staff from twelve professionals to just one economist. It goes on to point out that many business economists who once enjoyed successful careers in macroeconomic forecasting have fallen on hard times during the past few years. Citing the work of Stephen McNees of the Federal Reserve Bank of Boston, the *Forbes* article then asserts that most macroeconomic forecasts have such great margins of error that one can do as well simply by straight-lining recent economic history, without the use of any economists at all.

The article also notes, ironically, that a former chief economist of a major corporation is now working with attorneys who sue employers in wrongful dismissal cases. Adding insult to injury, it closes by stating that "business people no longer have use for such (economic forecasting) services, but naive juries apparently still believe in them."[2]

The generally negative tone of the article aptly portrays what many people apparently think about the future of economists in banking and the business world. Against that backdrop, the purpose of this article is to reexamine the changing role of business economists in general and bank economists in particular.

THE HEYDAY OF BANK ECONOMISTS

After the winds of World War II abated, the economics departments of money center banks were widely regarded as some of the most credible forecasters of our nation's and the world's economic fortunes. In fact, a number of the major banks circulated economic newsletters that had a wider distribution than all but a few daily papers in America's major cities. The largest of these was published by Citibank and, at its high point, over 300,000 copies were distributed. They were read by the industrial and economic elite of America, and by business leaders and government officials throughout the world.

In that environment, dozens of talented bank

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[1]See footnotes at end of text.

economists rose rapidly through the ranks on the financial management side of their institutions. The most successful of these earned top management titles such as Executive Vice President, Vice Chairman, President, and, in a few cases, CEO. Such noted business economists as Gabriel Hauge, Wes Lindow, Hebert Prochnow, Lee Prussia, Tom Storrs and others like them, retired as either the number one, two, or three person in major money center and superregional banks. In addition, dozens of other professional bank economists rose to the level of senior vice president or vice president and served as members of the management committees of America's leading banks.

The economist's path to the upper echelon of such banks usually started in the economics department, where they would normally begin by working on macroeconomic analyses and/or in money market forecasting. After rising to head his or her department, the most successful bank economists would then be given added responsibility for strategic planning, the money desk and/or foreign exchange operations. The final and most difficult steps, which usually led directly into the executive suite, involved moving beyond money desk management positions and into the chief financial officer position — alongside the CEO and president of the bank.

Along this road to the executive suite, the postwar economist would also often play a leading role as an external spokesperson for the bank. A. Gilbert Heebner, Walter Hoadley, and Beryl Sprinkel were good examples of economists who played the latter role while serving as members of their banks' senior management committees. Nowadays, only a small handful of the surviving bank economists still play such highly visible roles. And few enjoy the respect that the prior generation of bank economists took for granted.

In short, bank economists have experienced an ignominious slide from glory that raises two questions. First, exactly *what* happened? Second, *why* did this happen to so many talented economists in a key sector of America's economy?

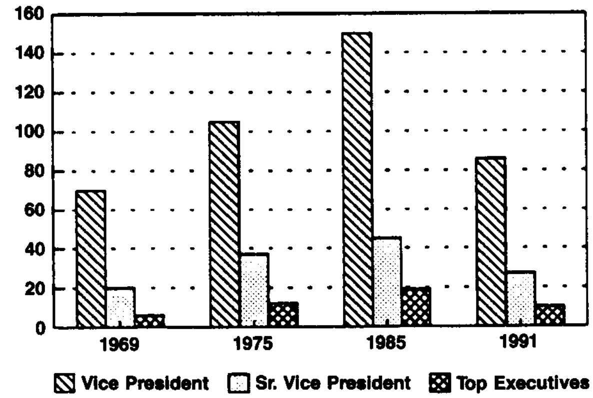
THE DECLINE OF BANK ECONOMISTS

Over the past two to three decades, the majority of bank economists have been listed in two major directories. The first, of course, is NABE's *Directory of Business Economists*, published annually over the past three decades. In addition, since 1973, the American Bankers Association has published its own *Directory of Bank Economists*.

Trends in the population of bank economists, from the NABE *Directory*, are reported in Figure 1. The first bar shows the number of economists in NABE's database carrying the title of Vice President for each year. As of 1969 there were seventy such positions listed in the *Directory*. By the mid-1980s the number had more than doubled, to about 150 positions. Finally, since the mid-1980s, a precipitous decline has been recorded — to the point where only eighty-six positions were listed in 1991.

Figure 1

Bank Economists
National Association of Business Economists



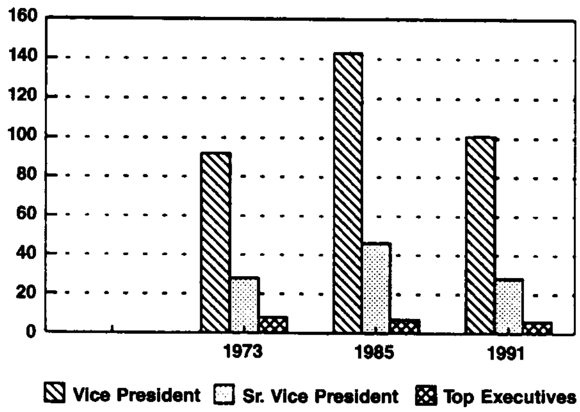
MEMBERSHIP DIRECTORY: 1969, 1975, 1985, 1991

The second bar for each year in Figure 1 shows the number of bank economists carrying the Senior Vice President title, which most often identifies the head of the economics department. Again, the number of such positions more than doubled between 1969 and 1985, from twenty to fourty-five, followed by a sharp drop, to only twenty-seven positions by 1991. The third bar shows the handful of economists who achieved the most senior positions of Executive Vice President, Vice Chairman, President or Chairman/CEO. The pattern in these positions mimics the pattern for bank economists in general.

Turning to Figure 2, the ABA's compilation of economists in officer positions, we see very similar trends. By 1973, the first year the ABA *Directory* was published, ninety-two bank economists held Vice President positions. That number rose to roughly the same level registered in the NABE *Directory* (i.e., about 150) by 1985. Again, the ABA's directories show that, between the mid-1980s and 1991, the number of Vice President positions fell to 101. Similar trends are also seen in the Senior Vice President category, with 1991 listings that are nearly identical in both directories. Finally, the tabulation of higher level titles in the ABA directories also shows a declining trend at the top levels of bank management. Here, however, the decline apparently began earlier than the general decline

Figure 2

Bank Economists
American Bankers Association



DIRECTORY OF BANK ECONOMISTS: 1973, 1985-86, 1991-92

among the bank economists, according to the ABA data. (Caution is urged in interpreting the data for top executives due to the small number reported.) In short, both directories trace a long rise followed by a sharp decline in senior officer positions held by economists in the banking industry.

We have not attempted to inventory the number of bank economics *departments* that have been disbanded or decimated. We should note, however, that such major banks as Bankers Trust Company, Chase Manhattan, Chemical Bank, Citibank and Continental Bank have either eliminated or reduced their economics departments to a vestige of their former glory. Finally, with the exception of Terrence A. Larsen at CoreStates, we are aware of no major money center or super regional banks now *headed* by economists, and only a few still have economists in top executive positions.

Without belaboring the subject further, we believe the foregoing data adequately document a sharply declining role for bank economists in senior bank management positions.

WHY HAS THIS HAPPENED?

One of the more obvious causes of this decline in the population of senior bank economists is the steady stream of mergers among large banks. For example, when Crocker Bank was merged into Wells Fargo Bank a few years ago, two economics departments became one. The surviving cadre of economists in the merged bank was much smaller than the number that worked in the two departments prior to the merger. And that outcome, for bank economists, was a happy one compared to what has happened in other major mergers. For example, when the venerable Irving Trust was forcibly merged into the Bank of New York (BONY) via a hostile takeover a few years ago, the Irving's highly respected economics department was simply disbanded. And the combined new entity has no centralized economics department. In other cases, such as the recent mega merger between the Bank of America and Security Pacific, a major cost-cutting drive is generating another batch of "merged out" bank economists searching for new jobs.

Another trend that has undermined the role of macro forecasters in banks has been the shift away from managing interest rate exposures via forecasts toward the newer concept of duration gap management. Rather than attempting to exploit expected movements in interest rates, the latter seeks to immunize a bank's earnings stream against changes in interest rates. The financial regulatory agencies have reinforced that trend by requiring banks and thrifts to present and implement formal duration-gap management policies. As a result, bank economists specializing in interest rates forecasting have found themselves without a mission. And, in most cases, finance technicians have taken over the "gap management" function formerly handled by economists.

Another change that has impacted employment opportunities for bank economists flows from the rise and fall of international lending by America's major banks during the past two decades. During and after the energy crisis of the early 1970s, the top money center and regional banks rapidly expanded their portfolios of international loans, particularly to third-world nations. This, in turn, brought on an expansion of international economics staffs to evaluate and monitor the borrowing nations. Then, during the 1980s, as more and more of those loans went into default, the pendulum began to swing the other way.

At first, banks simply sought to stop *voluntary* new lending to the LDCs. As the crisis deepened, more drastic action took place. The so-called "petrodollar loans" were restructured with frightening regularity, and partial debt forgiveness was often incorporated in these arrangements. Then, in 1987, Citibank took decisive action with a massive addition to its international loan loss reserves. After that, chargeoffs were often dictated by the bank regulatory agencies. Finally, banks sought to rid themselves entirely of such portfolios, or at least to reduce their exposure, through loan sales and/or equity swaps. Toward the end of the 1980s, many of these loans were sold (or swapped) for less than 20 cents on the dollar. At the risk of restating the obvious, banks them found themselves with an excess supply of international economists.

Having been badly burned by its expensive foray into international lending via petrodollar recycling, the banking industry then shifted its lending focus back to the domestic scene. Its two next targets of choice were: (1) financing corporate takeovers via so-called highly leveraged transactions (HLTs); and (2) financing land development and commercial real estate projects. In both cases, the basic principles of conservative bank lending were compromised extensively as competition to lend in those sectors intensified. The thrift institutions, in particular, added significantly to competitive pressures both in the real estate loan markets and in the junk bonds markets that fueled the HLT juggernaut.

As this major restructuring of bank loan portfolios came on stream during the mid-1980s, the massive fee income and accrued interest "earned" on such loans mounted. Bank economists were rarely involved in analyzing the questionable economic rationale that supported decisions to expand those portfolios rapidly. Rather, the loan officers involved too often accepted the rosy economic assumptions of the takeover moguls and the equity-poor but concept-rich developers who brought such projects to them. Nevertheless, the corporate staffs of bank economists continued to expand moderately as long as reported bank earnings from these portfolios held up.

Eventually these lending bubbles began to burst around the nation. Initially, the thrifts bore the brunt of collapsing real estate values, especially in the Southwest. Many thrifts that had survived the interest rate squeeze of the early 1980s emerged with thin and questionable capital bases. Therefore, they could not withstand the second blow that came during the mid- and late 1980s, when the tidal wave of commercial real estate losses hit them. As the larger thrifts began to falter, the cadre of bank economists working for major thrifts institutions, of course, also began to lose their jobs.

At first, the banks that were also heavily involved in HLTs and commercial real estate loans thought their industry was immune to the problems engulfing the thrifts. However, as the 1980s progressed and the economy began to falter, write-offs of bank real estate and HLT loans also began to mount rapidly. That, in turn, added impetus to the bank merger trend, mentioned earlier, which had previously been driven largely by the unwinding of legal/regulatory barriers to interstate banking.

Finally, as the number of bank failures mounted from an early postwar average of less than ten per year to approximately 200 per year, the focal point of management attention switched from asset growth to expense control. That, in turn, created a very intense interest in cost justification of all staff functions. Because most economics departments are generally cost centers and not significant revenue producers, senior executives found it increasingly expedient to reduce or totally eliminate them.

In fact, cost containment was probably the single most important factor behind the recent decline in the fortunes of bank economists, particularly when positioned against a new and less respectful attitude toward forecasters. As the 1980s ended, banks began to view marcoeconomic and interest-rate forecasters as irrelevant for their business plans. Without commenting on the wisdom of that conclusion, we can offer a number of reasons for it, in addition to the shift to duration gap management that has already been discussed.

First, sustained growth during the 1980s began to create the illusion of perpetual growth. To many business managers, the business cycle was dead, inflation was subdued, and the traditional end-of-cycle excesses had not surfaced as the expansion aged. In that environment, straight-line projections were often viewed as more cost effective than maintaining a professional forecasting staff. Alternatively, managers could use any one of several "consensus" forecasts. The most prominent of these, of course, is the *Blue Chip Economic Indicators*.

Second, as the 1980s progressed, many business economists' growth and inflation forecasts were simply inaccurate. Such inaccuracies cast serious doubts on the value added of economic forecasts in general. In hindsight, users of such forecasts may have had inflated expectations about the precision of economic forecasts, thanks to the proliferation of computerized macroeconomic models. And that overinflated sense of precision may have amplified their disappointment with subsequent forecast inaccuracies.

Third, during the mid-1980s some prominent economists regularly issued dire economic forecasts that did not materialize. Many of these forecasters saw a reacceleration in the inflation rate, with spillover effects on interest rates. Even now, with core inflation around 3.0 percent and lagging credit expansion, many economists are critical of the FOMC's move to drive interest rates down. Once again, those critics see the Fed's action as confirming that higher inflation is just around the corner. The business world, on the other hand, now sees the economics profession as preoccupied with the last war and out of touch with the realities of the current economic environment. Thus, if economists lack an understanding of "what really matters," why should the business world finance their craft?

Fourth, proponents of HLT and commercial real estate lending saw little or no need for economic analyses of their loan markets. Moreover, bank economists' warnings of the risks inherent in such loans were regularly disregarded by line officers. After all, persistent inaccuracies in macro forecasts hardly instilled confidence in economists as industry analysts. In addition, the business line officers typically considered such warnings as irrelevant because they believed their loans were adequately secured by the real assets of the borrowers.

Fifth, even when economists did direct their efforts to specific business line issues, those efforts were often hobbled. With their complex models and seemingly incomprehensible theories, economists were considered out of touch with the realities of specific bank markets. In addition, their demands for accurate microeconomic data as input into their analytical processes often simply could not be met. Line officers therefore began to view the economist as a person whose language was too arcane and whose data demands too rigorous to be of much use on the product line level.

Taken together, these perceived shortcomings isolated the economist from the decisionmaking processes in many banks.

THE FATAL PROBLEM

In sum, as the second half of the 1980s unfolded, the economist was seen increasingly as irrelevant to the banking business, both at the macro- and microeconomic levels. This growing sense of irrelevancy was reinforced by the new banking culture that emphasizes having all expenses driven strictly by the bank's line businesses.

Furthermore, the emergence of detailed profit center accounting may also have intensified the decline in demand for bank economists. During the heyday of large centralized economics departments, their expenses were typically part of general corporate overhead. That overhead, in turn, was allocated among an institution's businesses by various formulae. The most popular formula in banking, as well as elsewhere, was based on proportionate sharing of overhead expenses. In its simplest form, a given line division was allocated a share of corporate overhead based on that unit's direct expenses or sales, measured as a percentage of company-wide direct expenses or sales.

Such overhead allocation formulae were thus used to spread the cost of the bank's economics unit, without regard to its perceived value to particular line businesses. With intensified focus on cost control, however, a more direct approach to allocating overhead was adopted. Not surprisingly, such expenses, both in banking and elsewhere, bore a heavy share of stepped-up overhead cost-reduction efforts. Under this new regime, if a particular overhead item had no perceived value added to the line businesses, it became expendable. And if it had value added, the activity was then often transferred to the business line that perceived the value. Either way, the cherished independence of the economics department was diminished. Thus, centralized economics departments were either eliminated or reduced to handling public relations functions and/or regulatory issues of clear importance to the overall institution.

THE OUTLOOK FOR BANK ECONOMISTS

As noted in the *Forbes* article, a growing number of bank economists who formerly made their living as forecasters have found a variety of ways to apply their skills in other roles, both within and without the banking industry. The case of Alan Murray, formerly of Citibank, may be indicative of what has happened to many of his peers. He subsequently became a senior analyst in the *credit* division of the Fuji Bank in New York.[3] Many other former business economists, including the authors, have found their way into satisfying positions within the academic community.[4] But, for those who remain in the industry, we believe there is a strong incoming tide that is sweeping them into line and staff positions outside of their own economics departments.[5] Thus, while Citicorp no longer employs the small battalion of about 120 economists and support staff that once worked under Leif Olson in their Economics Department, it still employs dozens of economists spread throughout the company, mainly in microeconomic positions. Also, a cursory review of the titles held by many bank economists who are still listed in the NABE and ABA directories suggests that the Citicorp pattern of using economists in line areas has spread.

That brings us to the final question to be addressed in this article, namely: Is there a future for economists in the banking industry? And, if there is, what is the likely career path that the next generation will follow?

In that connection, we believe that future job opportunities for bank economists can now best be viewed in terms of spiral-shaped career paths. During the first generation after World War II, successful bank economists followed a fairly straight upward path through the economic and financial management side of their banks. We believe the new path will cut a broader and more circular swath through the entire bank. On this new path, professionally trained economists may well develop a variety of ways to apply their skills throughout their banks. Thus, it would not surprise us to see a new generation of economists emerge, once again, as top executives. But, to do that, they must more clearly demonstrate the practical value of their economic training in managing line areas of their companies. They will also have to demonstrate that the skills of well-trained economists are as valuable to their banks, as, say, the mindsets and skills that MBAs bring to the management ranks of financial institutions.

In fact, by moving upward through a variety of line and staff functions, in competition with MBAs, the new generation of bank economists may be better qualified than their predecessors who rose to such positions along the more direct, but narrower, financial management pathways. We feel confident that professional economists are well equipped to compete in managerial contests that require the winners to show they can understand and manage technological change, shifting cost (i.e., production) functions and — most importantly — the emerging nationwide and global markets for a wider and wider range of financial products and services. In short, if having "global vision" and a real understanding of how and why complex systems evolve are becoming the coin of the managerial realm . . . who should be better able to play this game than economists?

FOOTNOTES

[1]Dana Wechsler Linden, "Dreary Days in the Dismal Science," *Forbes*, January 21, 1991, pp. 68-70.

[2]Ibid, p. 70.

[3]Alan Murray, "The Business Economist at Work: The Credit Division of Fuji Bank," *Business Economics*, January 1988, pp. 49-50.

[4]James L. Essing, "The Transition from Bank Economist to University Professor," *Business Economics*, October 1990, pp. 38-43.

[5]Donald Anderson, "The Business Economist at Work: Change and Evolution in Courtlauds," *Business Economics*, April 1990, pp. 51-54.

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