

Talk before Montana Bankers Convention

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AMERICAN BANKING MYTHOLOGY

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A few years ago, Clarence Randall, formerly President of Bethlehem Steel, wrote a book called "The Folklore of Management." Today I want to direct my remarks to the myths about banking -- some held by bankers themselves, some by the public, and some by regulatory agencies. A period like the last ten months has been well calculated to test the vitality of these myths as the cross currents of our economy have swirled through the money markets. As one who believes something rich and colorful would go out of our lives if we were to be stripped of our folklore, I am pleased to report that none of the traditional myths of banking have been lost, and to the contrary, a few exotic ones have been added. If some of my remarks seem flip, put them down to the skepticism and irreverence born of twenty-four years of tax practice -- and surely those years spent in the marvelous world of fact and fancy between the federal government and its unwilling and resourceful contributors were well calculated to increase both qualities. But I hope this little exercise will do more than alternately amuse and irritate you. Never before have bankers been under such pressure to think seriously about their industry and its directions. This is more than the usual "I view with alarm" exhortation -- the future, properly charted, is one of immense potential, as well as one of possible peril.

What are some of these myths? Near the head of the list is this one - "Banks are the bastions of free enterprise." This is held as an article of

faith by most bankers, a few of those in regulatory agencies, and almost none of the public. It has many of its finest supporters in some of the banks located in the one-bank towns, with their strongest expression reserved for the hearing on another charter applied for by a would-be competitor. Anything which would disturb the even tenor of the local scene is fiercely rejected. It is kind of an upside down Alice in Wonderland world inhabited by these people, where monopoly becomes free enterprise; competition a socialistic device; and the relentless evolution of banking, like that all industry is undergoing at the hands of the computer programmer, a repudiation of the American way of life.

Attached to this myth is the one that the "community really wants a locally owned bank." The velocity of savings accounts and customers in this period of rate wars should have done much to dispel this illusion. In a discussion of this point a few months ago in Minneapolis, one corporate treasurer confided in me that he was loyal to his bank - as long as the spread did not get any wider than an eighth. In those cities in the district where it may be a little more trouble to hunt up the better rates, the loyalty factor may widen to a half. But money rates and service capabilities have two-way loyalties -- failure to keep even with competition is a defection from your customers, a breach of loyalty on your part your customers will punish by withdrawal.

And the banker himself - given an opportunity to sell out at \$300 per share, or \$400 per share, the sale understandably takes place at \$400 per share. I say "understandably" - unless the buyer happens to be a holding company or a banker from another town, in which case comprehension goes out the window. In that case, there are those local elements - usually in the

competing bank or savings and loan - who can be heard to lament that "old Bill" really turned his back on the town. When this happens I remember the time a certain area of the state woke up one day to find the third generation rancher in their midst who had tried for a year to sell his ranch locally, had sold his ranch to the Hutterites at just twice the highest price he had been offered by neighbors. Every hand was raised against him for having taken the highest price offered - unfortunately he had wisely removed himself from the area, and making the highest profit legally possible is not yet an extradictable offense.

But there is the converse of these two myths. Banking is a public utility, a stable conservative industry, headed by statesmen, and with an assured profit. This is believed by many people in regulatory agencies, a substantial part of the public, some Congressmen, and a few bankers. When all hell broke loose last winter following the discount and Regulation Q changes, there was consternation among these believers at the unbridled enthusiasm with which bankers started to compete with everyone in sight - each other, savings and loans - every savings institution became fair game. I am not sure who in the financial sector profited, but there is no doubt that this was a windfall for the advertising media not seen since the Clark-Daly fight in Montana, and the criticism is still resounding in the public forum. And why? For doing what comes naturally? Once the Fed had removed the artificial restraint in money markets, or to use Chairman Martin's favorite analogy, once the boulders had been removed from the stream of money and credit, new natural levels of equilibrium were sought by normal market processes. That this equilibrium has not been found - or that some of those in the regulatory agencies and the industry have been caught in the deluge

with their water wings partially deflated - has been the focus of criticism of the banking industry. I use the term "banking industry" with some reluctance, for it connotes a monolithic structure with a singleness of objective and a unanimity about the means of attainment which I suspect simply does not exist. Granted a singleness of purpose - the making of an honorable profit - there is little or no unanimity in any other particular. There are those - and I am one - who would hate to see this unanimity emerge. In this world you take your lumps as they appear and are delivered in the inexorable processes of the interplay of society. The prize is worth the game - and the chance of failure.

The banking institutions of the United States are of bewildering and almost infinite variety. This is as it should be, for they are shaped by not only the communities in which they are located, but what in many cases are specialized markets. To force all banks into a common mold, administratively or legislatively, would be to destroy this flexibility so essential to economic development.

To reverse the coin, bankers are part of free enterprise. They, large and small, will react as wisely and as foolishly as society permits. And the wide spectrum of possibilities had better be anticipated - plus a generous allowance for the unexpected - or bankers and regulatory agencies alike will be confounded. There is a law, known as Murphy's Law, and not as well known as it should be, that the unexpected always happens. This is not a well ordered world, nor is the banking industry a public utility. It is made up of over 14,000 units, big and small, with aspirations (if not deposits) equally divided, with disparate political effectiveness, and at least 6000 different measures of economic effectiveness in their communities. Big banks,

little banks, and regulatory agencies alike must recognize this variety and exercise a modicum of tolerance.

Banking does not have an assured place in our society - at least in the framework accepted many places in our district. The process of social and economic change has made banking one of the most dynamic and exciting elements of our changing world. But this change is only part of the whole transformation of money and credit which has many more elements than banking in a conventional sense.

Perhaps as part of this general division of the mythology belongs the belief that "bankers like tight money." This is held by most of the people, a surprising number of the bankers, and a few of the regulatory agencies. It is not an article of belief in the Federal Reserve System - particularly in the district banks. The firm support of tight money as an inflation hedge undergoes a mysterious change somewhere between the banker's desk and the discount window. I am reminded of my rancher friends who stoutly maintained they had no territorial ambitions whatsoever; their only reason for buying the additional property was to square up the ranch by getting the place next to them. So it is with bankers. All they want is enough money to take care of their regular customers. Close scrutiny of the word "regular" sometimes reveals a confusion between the present and future tense -- a hoped for result than a cause.

The phrase "enough money" is also a hard one to define. The dampening of credit demands of American industry, particularly for plant expansion, is a prime target of monetary policy and has been for nearly a year. We are in an inflationary period and excess demand is hardly less of a problem today than it was twelve months ago. A prime contributor to this excess demand

has been the rate of industrial spending for plant expansion and equipment. The only way monetary policy can be effective is by constricting the supply of money available for the entire economy, with the pious hope that the constriction will be fairly generally applied. Obviously this cannot be the case, and has not been the case. I question whether even rough justice has been done. Generally speaking, the best customers - the desirable banking relationships - are the corporate customers, and it is these that are contributing to the 17 per cent rate of growth in industrial spending. Caught in between stockholder demands, board pressures, and the fierce competition for these accounts, the bank officer understandably is going to cut these customers last. Unfortunately their demands are seemingly insatiable. With the limit of the average bank's resources today, all I can say is don't expect the discount window to be administered in any different manner today than it has been over the years since Regulation A was first announced. Whatever private sympathies we may feel for the difficulties of your position in this time of stringency, you can take some comfort from the plight of the Open Market Committee, which is currently and has been for the past few months assaulted from a number of directions - militant members of Congress, savings and loan associations, mutual savings banks, the construction industry, are just a few of the sectors of the public who feel that the thrust of monetary policy has been misdirected.

"It can't happen here" is a myth of many areas of the United States that regard themselves as outside the mainstream of change. There has been a measure of ill-concealed satisfaction at the plight of savings and loans these last few months. Well, the discomfiture of a part of the savings industry as large as that occupied by S & L's and mutual savings banks,

particularly when viewed against the role these segments play in a politically sensitive sector like home building, cannot be disregarded. Breezes blowing about the halls of our government can reach hurricane strength when sent out across the country:

Trends in the banking industry which usually surface in the top ten or fifteen largest banks - but not always - are transmitted throughout the country internally and externally. Externally is important to remember. The sophistication of your customers is a factor to be reckoned with. Trade associations, national news letters, conventions, business gossip - all of these are instruments of communication working rapidly and effectively to spread the news of new banking services, rates, - in short, the whole range of the most advanced elements of the credit industry across the United States. The dazed banker in Everytown, U.S.A., can sympathize with the U. S. Cavalry when confronted with the Sioux telegraph which operated invisibly, without any apparent physical means, to signal shifts in the deployment of forces.

Banking is not a conservative industry. It takes risks and pioneers into uncharted areas - or at least the leaders do - with a seeming unconcern and bravado that would do credit to the hardest pre-World War I entrepreneur. Commitments to hardware and system installations involving proportionately enormous sums; credit cards; the checkless society; loans to esoteric industries involving industrial developments and processes the banker often cannot pronounce, let alone understand; these are made quickly, perhaps with some misgivings, but made in any case. Customers do not fall into comfortable niches any more. Even in livestock lending, bankers are gradually yielding, slowly and reluctantly, to the patterns forced upon them by the PCAs and other specialized livestock credit institutions.

Another myth akin to "It can't happen here" is the one that small banks, or not so small country banks located outside the metropolitan centers are in some way immune from the process of change. Not only is this not true, but because of the subtle and insidious way in which economic change is accomplished, there is a special dimension to the change when realization finally comes. Without the depth of staff, of training, of general awareness, the banker who has been oblivious of the forces at work in the credit world has had it.

From this myth logically follows the converse again - that the country banker is doomed anyway, so why fight it. This is simply not so. There is a useful and important place for the country banker. In this district particularly, the people are scattered over a wide area - an area so extensive that the small banker has a locational advantage to be exploited if he so wishes. Sure, credit capacity is a problem. So is the cost of banking hardware and the expanded services demanded with a right of entitlement by the customer. I will not presume to tell you the solutions. I have some suggestions, but ultimate solutions for your bank will be conditioned by your response to its problems. Use of computer centers; pooling of bookkeeping through cooperative enterprises; increased use of correspondent services - which I might add will require some rather major adjustments from both sides to the relationship; possibly more small holding companies; even basic legislative changes looking towards modified forms of branch banking. I don't know which route or routes to take, and it would be presumptuous for me to speculate from this platform. I am sure of this - bold changes are essential in the Ninth District.

But I have a faith - a conviction that answers will be found. Pride and profit are legitimate and wholly desirable spurs to the inquiry. In a free society these furnish both the carrot and the stick.

By this time, you have probably detected that I am a passionate believer after all in the first myth I enumerated. American banking is a primary bastion of free enterprise. It is said of Christianity that if Christ had not lived, he would have had to be invented. There are credos of faith we must accept as the rationale upon which our reasoning processes must depend - what the Thomists referred to as self-evident, articles of faith from which we must start building. Faith in free enterprise is one of these. I believe in it. Most of you do, too. But it is only a point of departure for an imaginative action program. We must start our building process. I think we can. But the proof is in each one of you - in your hands alone.