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Remarks by

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Board of Governors of the Federal Reserve System

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Several years ago I had the opportunity to see one community that is a living lesson to an economic principle. In western Massachusetts lies the beautiful New England town called Westfield. It is an attractive place to live with fine industrious people, beautiful white church spires, a flourishing economy and, in the fall, glorious autumn trees. On the edge of town there is a little sign that attracted my attention. It was labeled "Whip City, Massachusetts." My friends there told me that the town was indeed the monument to the buggy whip that's been talked about so long. To me it was interesting to see how these wonderful people finally overcame their earlier mistaken idea that the end product was a buggy whip rather than a means by which human beings could go faster.

Ironically, I now live in another single-industry, single-product town, Washington, D.C. The majority of people who live there produce laws, regulations, rules, orders, hearings, studies and reports. The people who live there are not unlike those in many other single-industry towns. They often confuse the product with the purpose that it was designed to serve. They think of the product as the end rather than the means in order to reach an objective. Somehow, we need to find a device that will reorient Washington thinking to assure that the only purpose of government is to improve the lives of the citizens whom it serves. In too many instances the people would be better off if we cut back production of those laws, regulations and studies.

Your business of banking is an excellent example of the consequences that we are experiencing from excessive regulation. I think that the purpose of your industry should be to provide a safe, convenient place to store our savings. It should furnish a cheap, fast means of effecting transactions and it should provide a system whereby the savings of some of us can be used to create more goods and services for all of us.

While the banking industry does perform these functions today, I don't think it is performing them as well as it could and should. One of the principal reasons is that it has become shackled and burdened by overregulation. While any banker could agree with this statement and could give an extemporaneous speech on examples of overregulation today, I'm not sure as many would be able or willing to discuss how overregulation also means overprotection.

And overprotection is the second reason banking has not met its potential. Due to overprotection and a lack of competition in the banking industry, some bankers have lost sight of their purpose. They have become so skilled in the application of old tools to meet old needs that they have not taken the trouble to reexamine the effectiveness of those tools, or to ask themselves whether new tools could do the job better.

As a result of both of these impediments, other financial intermediaries have sprung forward to meet the new needs of our society and to fill the gaps that the banking industry has left unserved. As the banking industry has become ossified and encrusted by ancient practices and counterproductive laws, others are finding ways to circumvent these restraints in order to meet the demands of the public.

While I hear many screams of injustice from bankers around the country about how nonbanks have preferential treatment or special privileges, not many are willing to admit that these special privileges grew out of a lack of competition in the banking industry itself. Whether you agree or not, the general public thinks that the banking industry is generally anticompetitive. They see the restraints on geographical activity and the restrictive chartering as being primarily protective of your interests as bankers, not the public's interests. The public sees too many banks as owning a small kingdom that is protected from outside invasion. And a kingdom of any kind with no in-migration or threat thereof is highly vulnerable to stagnation. Denied in-migration, such a kingdom is also denied the industriousness and the vigorous competitive spirit that immigrants bring with them, particularly when those immigrants are bankers or businesses.

The result is that banks are, to a certain extent, protected from the freedom to fail as well as the freedom to compete and succeed.

I think it is time to tear down these artificial barriers into the banking industry and to open the borders of banking to any who wish to come or go. Banks, like all other business organizations in our country, should have the freedom to open up shop where the needs are greatest and the opportunities strongest. Not only should we allow state-wide branching by any bank organized within a state but we should also authorize interstate full-service operations for any bank authorized to do business in our country. It has been the partial breakdown of these artificial geographic barriers that I believe has thus far been the greatest public benefit of the bank holding company movement.

Now some small community bankers feel the result of the elimination of these restrictions would be the demise of their organizations. I disagree! Any local community banker worth his salt should be able to hold his own against a large, lumbering, bureaucratic bank from out of town. Look at states like North Carolina and California. In each of them you see healthy, profitable, successful community banks that provide an attractive alternative to the public in competition with the giant state-wide banks that operate there.

Given the present phobia about unrestricted branching on the part of some bankers, I find it hard to understand how the House of Representatives could overwhelmingly pass, as it did, a bill to give foreign banks the authority to branch across state lines. It seems to me inconsistent to have these foreign visitors enjoy privileges that we don't authorize for ourselves. Certainly we should have one rule apply to all who are striving to perform the same public function. If this legislation is adopted, we should then have another new law that gives all federally chartered banks the freedom to operate throughout the United States without restrictions.

This special protection that the banking industry has enjoyed will in the long run lead the public toward policies that result in strangulation of the industry. One good example is our present overreaction to the bad practices of a few bankers. It appears that in some states, as well as in the Congress, there is a temptation to impose new restrictions on the right of individuals to own bank stock. Our country has had a long history of wanting to prevent an overconcentration of political or economic power in any one place. To prevent an overconcentration of economic power, we do not allow general purpose corporations to also own banks. This means that individuals must be able and willing to invest in banks. New restrictions on the rights of individuals to own bank stock will jeopardize the flow of needed capital into banks.

These proposed new restrictions are yet another unfortunate example of laws and regulations made in an events-influenced environment. When we see an evil produced by a notorious event, it is seldom that we acknowledge that enduring the evil would be less burdensome to society than the cure that is proposed. How long has it been since you saw a great tragedy or miscarriage of justice reported in your newspaper that wasn't accompanied by some proposal to pass a law against it? What we have is regulation by reaction.

Some claim that restrictions on individual bank stock ownership will better enable us to have a safe and sound banking industry. I doubt it. I don't believe that any Congress or any regulator can predict which individuals will run a safe bank and which ones will not. We cannot with sufficient certainty judge human capacity or predict human behavior in new or changing circumstances. Nor can we predict the economic environment of the future in which these individual capacities will be tested. In bad times, sometimes the sharpest and most competent banker can be snake bitten. Today's banking genius is tomorrow's banking fool.

And lethargic regulators are one of the groups least able to predict the future. Any criteria that regulators might use, though sounding good on paper, would in practice wind up being capricious and arbitrary. In those few isolated instances in which the change of control of a bank to a certain individual presents a clear and present danger to the public safety, I think that notice of the change to the regulators should be sufficient to address the evil in time.

Let's face the fact that ownership of bank stock is one of the few market-oriented disciplines left in the banking industry. We now have Federal deposit insurance which protects most depositors from loss. We even have developed a purchase and assumption technique by the Federal Deposit Insurance Corporation which has resulted in protection of most other bank creditors. To a limited degree our system of government inspection and supervision of the banking industry also protects stockholders from loss. I don't feel that it is the business of government to protect stockholders from losing their money or officers from losing their job. To the extent that they are not free to fail, they cannot have adequate freedom to succeed.

I think the industry as a whole has become overregulated by the way its supervisors set standards for a bank's capital and assets. We need to stop treating banks like public utilities and allow the market place by its own risk analysis to make a determination between the successful and the unsuccessful bank. No government official, regardless of how competent or well intentioned, can manage an individual bank or the industry as a whole as well as the collective efforts of bank stockholders, directors and officers.

Notwithstanding this fact, there is a place, and a proper place, for government intervention in the affairs of a specific bank. That is when the bank, by its own voluntary action, has become so dominant in its community that its failure will cause great public injury. Injury not only to its customers and stockholders but also to the entire community that it is chartered to serve. But use of the term "community" in this context means different things to different banks. It can mean the town in which a bank operates, it can mean the county, the state, even the country or perhaps the entire world based on the bank's relative size and position.

When the consequences of the failure of such a bank would be great injury to the public interest, then, and only then, must regulators supplant the judgment of bank managers and stockholders. While the judgment of such regulators may be subjective and imperfect, it is nonetheless necessary to protect the ultimate public interest.

Unfortunately, the present statutes don't give regulators the proper tools with which this ultimate judgment may be carefully expressed. Present bank supervisory authority is too broad, too indirect, often subject to overkill. Heavy-handed tools such as cease and desist orders for unsafe and unsound banking practices often effect more damage than healing. This is the fundamental reason I support the present legislative initiative to add additional, more precise and delicate tools to the supervisory capacity. Yet I nonetheless think we should reject the temptation for legislative overkill caused by a few isolated instances. The proposed supervisory tools will be more than adequate to do the job without subjecting the entire industry to massive further constraints.

The banking industry continues to be buffeted back and forth by the whims of circumstance in the very short-range perspective of the public. For a while you were subject to the criticism that banking regulators operate in an atmosphere of competition in laxity. Now I feel that you may be subjected to the new atmosphere which could be described as competition in piety. All too often bank regulators like myself are tempted to answer criticisms of our own actions by blaming the banking industry and inflicting some additional punishment on it. Instead we should have the courage to answer our critics by stating that the wrongdoing of an isolated few bankers is not representative of the industry nor does it deserve the overreaction which is often proposed. The vast majority of banks and bankers are responsible, capable and honest people who are equally able and willing to serve the public interest as well as their own. And the public interest would be best served by removing the shackles of regulation and restraint and giving them the freedom to strive toward doing so.