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BANKING -- THEN AND NOW

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Forty years ago banking services for the United States were provided by 32,000 offices, operated by 29,000 banks. At that time there was a banking office for every 3,700 people and banking was enjoying a golden age of prestige and affluence. But the awful depression and collapse of the monetary system was not far off. The structure of banking that came out of the wringer in 1933 was modeled on that of the twenties but the number of service facilities was almost halved; there were now about 8,000 persons per banking office. From that point, banking offices have increased steadily and somewhat more rapidly than population. Today there are 29,300 offices operated by 14,270 banks and the scale of banking provides an office for every 6,700 persons.

In these forty years--if we bridge the depression and World War II--the banking structure has changed to the extent that today we are serving roughly twice as many persons per office as were served in the twenties.

These customers are richer, too; personal income is at an annual rate of $510 billion now compared to $73 billion in 1924. Using GNP as a convenient proxy for measurement, today's annual rate of nearly $650 billion is over seven times that of 1924. Since the depression year of 1934 there has been an even more impressive 10-fold increase.

The expansion of income and output has, of course, been accompanied by other--often more startling--changes, not the least of which has been a very substantial increase in population--from

114 million in 1924 to 194 million today. This population has moved as it has grown--from country to city, from the east to the west, the north to the south. At the same time the manufacturing technology and business organization developments have drastically altered credit and capital requirements of the production sector of the economy. Also, it was in these decades that consumers came of age as credit users for owner-occupied housing, automobiles, and hard goods. These and many other evidences of changing times have imposed upon commercial bankers an unparalleled number of problems as well as unequalled opportunities to extend their business and expand services to their communities.

Looking over the whole period of a depression, a war, and a period of sustained economic growth, what can we say about the adaptation of the banking system to the changing environment? How well and how aggressively have commercial banks grasped the opportunity of the times--both for business success and to serve the public? How effective have banks been in maintaining their "share of the market"? If they have not--why not? Were the odds too great? Was regulation too confining? Was the competition too heavily subsidized? Did a sluggish non-competitive tradition in the banking industry prove self-defeating? I have no doubt you have pondered this problem often and with feeling and with a close knowledge of specific situations. Still I thought that, at my own risk, I might open up some of the issues in as objective a fashion as I can, because an evaluation of where the industry now stands, and why, has a bearing on policies for the future.

There are two ways of appraising the banking system's performance in maintaining its "share of the market." On the one hand, how well has it met the competition of other financial intermediaries and market instruments to satisfy the economy's needs for liquid asset holdings? Or, on the other hand, how well has it met the competition of other financial intermediaries and the capital market in supplying funds to business, consumers, and governments? Either the source or use-of-funds approach should lead to the same judgment on banking's share-of-the-market position. I will review the evidence on the source approach because it seems more straightforward.

The funds that the banking system garners in the form of demand deposits are fixed by the action of the Federal Reserve in supplying reserves to the banking system. But the Federal Reserve's decisions are made in light of its analysis of the demand for money (demand deposits and currency) by individuals, businesses, and governments. It is usually assumed there is little the banking system might do through its own efforts to increase the total of demand deposits. Of course, it could try to persuade its customers that non-interest bearing deposits are preferable to interest-bearing deposits and thereby increase the demand for demand deposits. Few bankers try this. We know most bankers use advertising and promotion to persuade individuals and businesses to invest in time deposits--some of this is obviously at the expense of demand deposits.

Not only are interest-bearing deposits being promoted but demand depositors are being encouraged via service charges to use their checking accounts more intensively, that is, to reduce the demand balance used for a given volume of transactions. All of this shows up in the turnover rate for demand deposits which now stands at a peak of 48 times per year. The comparable turnover rate in the mid-twenties was 35 and in the mid-thirties, 25.

There are some trends in the opposite direction--compensating balance requirements, for example--but the present-day banking system has not tried to sell the demand deposit for its advantage as a superior form of liquid asset, as well as a transactor.

Demand deposits, because they make up about 80 per cent of the money supply, might then be expected to have increased over the past four decades somewhat less or about in proportion to the change in national output and transactions. The statistics show that demand deposits are about 21 per cent of GNP, little changed from the proportion in the mid-twenties. Currency in circulation, on the other hand, has increased about one-fourth in terms of its percentage of GNP.

From all of this I would conclude that the banking system's share of the "money" market has held constant in nominal terms only. The economy in 1964 utilized far more money per billion dollars of GNP than it did in 1924 or 1934. This is evidenced by the growth in currency in circulation and the recent spectacular rise in turnover of demand deposits. In a real sense a significant share of the market was absorbed by technological improvements in the payments mechanism. On the other hand, the banking system has not shown much interest in a "hard sell" campaign to increase the attractiveness of the demand deposit as a liquid asset.

How have banks fared in the competition for the economy's liquid asset holdings other than demand deposits? We can define liquid assets for this analysis as currency, deposits at commercial and mutual savings banks, shares in savings and loan associations, U.S. savings bonds, postal savings, and Treasury securities with maturities of less than one year. This definition is not entirely satisfactory because at various times other assets have had equal, if not greater, liquidity. However, a definition taking into account changing composition in market instruments or institutional obligations would complicate the statistical task disproportionately to the refinements in the results.

Using this definition of liquid assets, we find that in the mid-twenties and mid-thirties banks had in demand and time accounts about 55 per cent of the economy's liquid asset holdings. Today, they have 47 per cent--a loss of 18 per cent in their share of this market. Having already examined the behavior of demand deposits, let us take a look at the result of the banking system's efforts to attract time deposits.

Commercial banks have always played an important role in supplying the public's needs for liquid assets other than demand deposits and currency. In the mid-1920's time deposits of commercial banks represented more than 25 per cent of the public's holdings of liquid assets. A decade later, this proportion had dipped to 20 per cent. Today it stands at 23.6 per cent, up from a low of 14.8 per cent in 1956.

Since the inter-War period the demand for liquid asset holdings has expanded greatly as both current income and wealth have risen. By 1959 such assets were more than six times their mid-1920s level and, by the end of 1964, at $534 billion, were about 8-1/2 times higher.

Since commercial banks until recently have failed to hold their earlier share of the market for liquid assets, we may ask who gained as they lost. U.S. Government Savings Bonds and short-term Treasury securities presently represent an important component of the total and these items were relatively unimportant prior to World War II. However, increases in them since 1946 are only a minor portion of the total increase and, as a result, Savings Bonds and short-term governments represent a much smaller portion of the total than was the case a few years ago. The components accounting for the greater part of the postwar increases in liquid assets held by the public have been the claims on nonbank private financial institutions.

For example, mutual savings banks' deposits represented only 11 per cent of the liquid assets held by the public in the mid-1920s. However, during the subsequent two and one-half decades mutuals' deposits expanded six-fold in contrast to a five-fold increase in commercial banks' time deposits.

The most aggressive competitors in the market for supplying liquid assets have been the savings and loan associations. During the mid-1920s, savings and loan shares amounted to less than 7 per cent of the public's holdings of liquid assets. This position was relatively unchanged a decade later but it had deteriorated substantially by the end of World War II. At the end of 1946, savings and loan shares represented only 3.5 per cent of the liquid assets held by the public. But about that time the trend reversed; during the late 1940s and 1950s savings and loan shares increased by about seven-fold whereas time deposits of both mutual savings banks and commercial banks only doubled and demand deposits increased by about 50 per cent. By the end of 1959 their market share hit a peak of 13 per cent. Clearly this was an era in which the savings and loan associations were most successful in supplying liquid assets on terms attractive to the public.

This is probably not an appropriate occasion, nor am I an appropriate person, to make a judgment as to why or whether banking--a regulated industry--for so long failed to maintain its market share. It is not for me to say it was because of lack of enterprise, initiative or competitive capacity, or perhaps owing to a congenital preference for things as they were. Nor is it appropriate for me to allege that the regulators, of which I am one, stifled the industry's impulses or attempts to better serve the community, to see the world as it is, not as it was. Nor should I judge whether or not regulators abetted the banking system's monopolistic flabbiness, discouraged it from adopting credit innovations, and caused it to knuckle down to bureaucratic prerogative because the sins of a past generation are the penance of this one. And I should not admit or deny that regulators, as well as banks, have growth ambitions.

It is better and more seemly to let someone else evaluate you and your shortcomings, and us and ours. Moreover, the force of circumstances probably had far more to do with banking's dilemma and behavior. The industry's attitudes, constraints, and aspirations still reflected the banking collapse of the 1930s and the consequent steps taken to reconstitute the entire system. It is not surprising that the new system, while eliminating known past abuses, could not do much about unknown abuses in the future other than limit banker discretion and initiative while providing for detailed surveillance by public authorities.

Clearly, in the 1930s, insufficient attention was given to restructuring the industry so that it might more effectively participate in handling the credit problems of a growing and dynamic economy. Commercial bankers generally then believed they should follow policies that would enable them to survive another liquidation comparable to that of the early thirties. And this was the kind of banking system that was expected, if not demanded, by an American public remembering the tragedy of widespread bank failures.

It seems to me that all participants--bankers, bank supervisors, and the public--were overly tardy in acknowledging the role commercial banks should be permitted to play in a growing economy. By the mid-1950s, however, these inhibitions developed during the 1930s were being cast aside. The results of this growing emancipation are now clearly evident in the performance of the commercial banking industry.

The 1960s appear to have marked the beginning of a new era for commercial banking. It seems to me that the vital difference between banking today and banking in the thirties, forties, or fifties, is its more aggressive attempt to serve a larger and larger part of the public's credit and money needs. The result of this more aggressive behavior is reflected in banking's growing share of the liquid asset market.

At the end of 1959, commercial bank time deposits represented less than 17 per cent of the public's holdings of liquid assets. As I have pointed out, this represented a lower share than was the case a decade earlier or during the inter-War period. The declining position of commercial banks as suppliers of liquid assets to the public was arrested in the late 1950s.

Since the end of 1959, increases in time deposits of commercial banks have constituted more than 40 per cent of the increase in the public's liquid asset holdings. As a result, commercial bank time deposits have been an increasing share of the total throughout the 1960s although the rate of increase fell off slightly during 1964. Thus, during the past five years, commercial bank time deposits, as a share of total liquid assets, rose nearly 50 per cent to almost 24 per cent of the total.

What accounts for this dramatic change in the position of commercial banks? It is commonplace to cite as the major factor the Federal Reserve's increases in the permissible rate on time deposits under Regulation Q. This was a necessary but not a sufficient condition. As is often the case, the impact of the System's actions largely depends upon the response of commercial banks. In this case the reaction was prompt and vigorous.

But time deposit rates are not the only evidence of growing competitiveness. Commercial banks have displayed more imagination in tailoring their products to customers' needs and convenience. The promotion of certificates of deposit to meet almost any customer situation comes to mind. The spectacular growth of CD's--from $1 billion at the end of 1960 to $14 billion today--evidences the widespread acceptance of this instrument.

The rate of increase of time deposits in commercial banks other than CD's has also exceeded the rate of increase in total liquid assets since the end of 1960. Mainly, this reflects the greater holdings of savings accounts by individuals and can probably be traced to a convenience factor. One of the most noteworthy developments in banking during the past few years has been the high rate of new office openings. During each of the past two years almost one thousand new offices have been opened. While not so high, the number of new offices opened for business in the three preceding years was also large relative to the annual rate of the preceding two decades. A substantial proportion of these new offices have been in suburban communities and all of them represent increased convenience to actual, and potential, bank customers. The increased time deposits derived from these more conveniently located offices represent only one aspect of the benefit that has accrued to bankers and their customers. These more accessible offices also enable commercial bankers to better serve the instalment and mortgage credit needs of the public--activities which have now been accepted as their responsibilities.

Looking back over the past 40 years enables us to gain a better perspective into the role of commercial banks in today's economy. It seems that two things are clear from this short review--the economy and, therefore, the needs and conveniences of the public have changed greatly and, as we have seen, commercial banks have been late in adapting to the changes and opportunities that confronted them. If they falter again they will surely fall behind other, more aggressive, financial institutions.

For most of you all of this is merely prologue. The coming years will bring forth more and more economic and technological changes for you to face. I hope you are prepared--well prepared--because it seems to me that the technology now in being has the scientific authenticity and the economic potential to produce more changes in banking in the next one-half decade than have taken place in the previous four.