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Remarks of J. L. Robertson

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Banking Reforms and the Corporate Customer

I am supposed to speak to you today about some of the reforms that lie ahead in the field of banking, but I propose to speak of changes instead. I would hope that one of the changes would be an improvement in the image of the banker. Too many people still tend to think of the banker as a steely-eyed, stonehearted automaton. I am reminded of a story told about a friend of mine, back in my home town, Broken Bow, Nebraska. He was told by his doctor that his heart was deteriorating and that he had only a few months to live. Being both desperate and affluent, he flew to South Africa to consult a famous heart surgeon about a heart transplant. The surgeon confirmed the diagnosis and told him that he was in luck. He had three hearts available. Which one would he prefer? One was from a beautiful young French girl; the second was from a forty-year old former boxing champion; the third was from a sixty-five year old banker. My friend pondered a moment and said: "I'll take the heart of the sixty-five year old banker." "Fine," said the surgeon, "but why that one?" My friend replied: "In my condition, I need a heart that has never been used."

I do not pretend to be a prophet, and I am acutely aware of the dangers of trying to predict what lies far into the future. Such speculations are often interesting, but they are also often wide of the mark. One thing we do know is that most of what will happen in the future has its roots in what has happened already or is happening now. One way of getting a feel for what lies ahead in banking and finance is to look at the changes that have taken place in the recent past, the types of movement that are under way and that will probably continue.

Let me discuss briefly some of the more important trends in banking that have been seen over the past ten or fifteen years.

We have undergone a considerable consolidation in banking through the merger process. As you know, there have been those who have applauded and encouraged the trend and others who have tried to slow it down. The key

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issue has been whether or not the consolidation promotes or diminishes competition in banking. On the one hand, the increase in the size of banks through mergers will enhance the ability of our banking system to serve the giant corporations with their tremendous demands for funds and a variety of services. The effectiveness of competition is not very great when we have a handful of giants arrayed against thousands of pygmies. On the other hand, it is a mistake to think that banks exist just to serve our giant corporations. One of the strengths of this country, over the years, has been the competitive system in banking that has given the small borrower, whether a businessman, a farmer, a home buyer, or a consumer relatively easy access to bank credit.

There is no doubt that many of our restrictions on banks, including barriers to branch banking and our antitrust laws, have prevented the kind of consolidation of banking that is found in most foreign countries, where a limited number of banks completely dominate the scene. While there are admitted disadvantages in this, I believe that there are more important advantages to bank customers, both large and small, in the preservation of our kind of system - a system composed of numerous competing institutions. Banks should not become so big and powerful that they dominate all other businesses and become inconsiderate of the needs of their smaller customers. I would anticipate that those who would like to see radical changes in this aspect of our banking structure will not have their way in the years ahead.

In a related area, we have seen a great expansion of activity by banks in nonbanking fields, largely through the device of the one bank holding company. As you know, this has been a matter of great controversy, which was finally settled by the passage of legislation lodging the regulation of one bank holding companies in the Federal Reserve System - despite the fact that we have our hands full with monetary policy.

The Board of Governors has published an initial list of the activities that one bank holding companies will be authorized to undertake, and has been holding public hearings

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with respect to them. In conformity with the statute, these must be limited to activities closely related to banking. We anticipate that this will accomplish the objective of enabling the banks to provide corporate and other customers with a wider range of services, but at the same time it will enable us to avoid the spread of bank control and competition to fields that have nothing to do with banking and finance. This will have distinct advantages for the corporate customer. It should improve the ability of the banks to provide desired services, and at the same time most of you will not have to worry about the big banks moving into your industry and taking over; and, in turn, they will not have to worry about you taking them over.

There is another very general advantage that I think is important. We have seen what can happen to firms that become so diversified and so big that they lose control of their operations. We do not want to see the safety of our banking system endangered by having the banks sink heavy investments of both money and talent into businesses that are far from their field of expertise.

One of the very significant developments that we have seen in banking over the past decade has been the tremendous expansion in the international area. This has accompanied the growth of the multinational corporation. American banks have been quick to respond to the opportunities and the demands of their corporate customers for better service in international trade and investment activities. This has been marked by the burgeoning of branches of American banks in all corners of the globe. American banks have played a major role in the development of the Eurodollar market as a very important source of financing for all manner of transactions, both long- and short-term. These developments are both welcome and worrisome.

I need not dwell at any length on the great importance that we attach to the expansion of American exports. The United States has not been doing well in this area relative to most other industrial countries. From 1965 to 1970, the average annual rise in our exports was between

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9 and 10 per cent. This looks good until we note that the exports of industrial European countries, as a group, rose nearly 13 per cent a year, and Japanese exports rose 18 per cent a year, or nearly double our rate of increase.

The weakness of the dollar in exchange markets, which has been so evident in recent weeks, is in some measure a reflection of this long-term tendency to fall behind our main competitors in international trade. We are going to have to do better in the future. The development of an efficient, internationally-oriented banking structure that can help American business compete more aggressively in world markets can be of great assistance in our drive to strengthen the dollar. This means that the banks must not only be willing and able to provide export financing, but they must do everything possible to help our exporters find and develop foreign markets for their products. I believe that this may require some changes in thinking that go beyond what we have already seen. Most of the people in upper level management positions today have been conditioned by the prevailing psychology of the early postwar period. This was the era in which the United States was the economic giant who entered the competitive ring with the attitude that he would have to pull his punches to avoid slaughtering the midgets that were put up against him.

It should be clear to all by now that this is no longer the case. We are going to have to compete harder abroad than we do at home. I think the great success of the Germans and the Japanese owes a great deal to the intense export orientation of the businessmen, the bankers and the workers in those countries. I would like to see our bankers, and our other businessmen as well, make a very thorough examination of their own attitudes, practices and structure with a view to determining what they might do to develop their ability to push foreign sales. Our banks have made a good beginning, but I have the feeling that we have yet to get the kind of attitudinal breakthrough that we will need in the years immediately ahead if we are to regain our lead in export markets.

In saying this, I know that it is going to be said that the government, and more specifically the Federal

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Reserve, needs this kind of advice more than anyone. We have been administering a Voluntary Foreign Credit Restraint Program for some six years, and during most of that period we have been under pressure from one group or another to relax or exempt from the restraints all export financing. As a result, we have kept a very close eye on the program in an effort to try to detect any evidence that exports were being denied adequate financing or that the program was hurting exports in any way. We heard many general charges, but we were never able to find concrete evidence to back them up. Nevertheless, the program has been relaxed as far as export financing is concerned in order to make doubly sure that it does not impinge on our objectives in this vital area. A careful study made only a few months ago indicated that there was no justification for any argument that our program was restricting exports by reason of the unavailability of credit.

Nevertheless, the criticism and the pressure continue. I personally hope that we will be able to dispense with this restraint program altogether before too long. I said from the beginning that it should be a temporary program and that it would be bound to create inequities and lose effectiveness if it were kept for very many years. Nothing has happened to cause me to change that judgment. I think that with the realignment of exchange rates that we have already seen and with renewed determination on our part to stabilize our economy and regain our competitive strength in international trade, we ought to be able to achieve balance in our international accounts without these special measures.

However, I must emphasize that freedom requires responsible policies. We cannot expect a program of complete freedom in international capital movements to function successfully if the United States generates more dollar outflow than the rest of the world is willing to absorb. I recall discussing this in a speech that I gave as long ago as 1959. I warned then that the price of continued inflation would be rigorous governmental economic controls and that this would include controls over foreign exchange. I also pointed out that if the inflation was not halted, we would encounter more and more pressure to erect barriers against

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imports to protect our industries against foreign competition. We have to decide whether this is the road we want to follow or whether we want to pursue a course that will enable us to forget about controls and about restrictive trade policies. This is a choice that is forced upon us because the rest of the world will not be willing indefinitely to give us the privilege of being the one and only country in the world that is permitted to disregard the balance-of-payments impact in the formulation of its economic policies.

In this connection, I would like to point out that it is going to be very difficult to maintain a sound and appropriate monetary policy if some of the "reforms" of the Federal Reserve that are currently being urged are adopted. I am thinking of the various proposals that would require the Federal Reserve to pour out its credit to support various favored sectors of the economy. There is currently under discussion in Congress a bill that would have the Federal Reserve institute an automatic discount program for export paper.

The objective of facilitating export financing is certainly in line with the desire all of us have of expanding exports. However, I am afraid that the method, well intentioned as it is, could seriously impede our pursuit of a sound monetary policy and a sound dollar.

Under the provisions of this bill, banks would be free to tap automatically the Federal Reserve till for huge amounts of credit whenever the System endeavored to tighten monetary policy. This would ostensibly be done in the interest of insulating export financing from the impact of tighter money, but it would have the effect of frustrating our efforts to tighten generally when this was called for.

It is important to note that this would not necessarily benefit our exports. Had this system been in effect over the past year, it is most likely that the banks would merely have used the privilege of borrowing from the Federal Reserve to obtain cheap money to pay off their more

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expensive borrowings in the Eurodollar market. It is conceivable that not a nickel of additional money would have been put into export financing.

I would also like to point out that important as liberal export financing may be, it is a serious error to think that any country, including the United States, is obliged to provide financing for all of its exports. Financing terms are only one of a number of factors that influence an export sale. Availability of the goods, price, delivery terms, quality, servicing and transportation costs are also important factors that a buyer takes into account. Where a country has a clear advantage over the competition in respect to these factors, it is usually not necessary to gild the lily by offering concessional financing terms as well. This is especially true in the case of those commodities in which there is no effective foreign competition. Our large jet aircraft is a good example. If we were to offer automatic financing of all our exports on concessional terms to all comers, the result would be a tremendous surge in our loans to foreigners, which would be recorded as increased capital outflow in our balance of payments. There would not be a corresponding increase in our export receipts, since we would, to a very large extent, merely be selling on credit goods that we had previously sold for cash. This would not be the way to improve our balance of payments deficit.

I would therefore hope that we would think long and hard before giving favored sectors automatic access to Federal Reserve credit in the years ahead. Such measures would hinder us, not help us, in the execution of monetary policy.

Before I leave the subject of export financing, I would like to say a word about a new development that is now under way. This is the formation of the Private Export Funding Corporation, or PEFCO, by a large number of banks that are interested in export financing. PEFCO has been designed to assist in financing the export of "big ticket" items such as jet aircraft. These items frequently require larger sums of money and longer terms than a single commercial bank or even a consortium of commercial banks can provide. The idea is that PEFCO will be able to raise

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longer term money by the sale of securities, with the backing of guaranties from the Export-Import Bank. These funds can be used in conjunction with loans from the commercial banks to help finance these very large transactions. A great deal of time and effort has gone into the organization of PEFCO, and I believe that it represents an imaginative solution of the private sector to an important problem. Hopefully, PEFCO will tap foreign sources of funds as well as our own market. It will do business at realistic market rates of interest. If it succeeds in raising sufficient long-term capital, it will help solve the problem of availability of funds for transactions that may have depended in the past on official financing. PEFCO will not meet the need for concessional terms in cases where foreign competitors are offering better terms than can be supplied without official support. However, as I have pointed out, concessional terms are not always required to move exports. I would hope that PEFCO would be given a fair trial and not be killed before it is born by measures that would put the burden of all our export financing on government agencies.

Turning back to the domestic scene, I would like to say a word about interest rates. I am not going to try to predict the course of interest rates. After the extraordinary and unforeseen fluctuations of the last year, it would be foolish to pretend that we can look very far ahead in this vital area. I will hazard a couple of predictions, however.

We are certainly going to have wider interest rate fluctuations in the future, and I think banks are going to have to find ways to cope more effectively with what may be rather sharp changes. They will have to be more flexible in the rates that they pay on deposits and charge on loans, adjusting them whenever necessary to keep in step with movements taking place in central financial markets. This may take the form of variable rates on term contracts. This has been resisted here in the mortgage field despite the fact that it has seemed to work in some countries abroad. However, there has been a trend toward adjustable rates in term loans to corporate borrowers

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based on fluctuations in Eurodollar rates. If these loans work out satisfactorily - and I have heard no reports of difficulties - I would not be surprised to see this practice spread. However, it is still too early to tell, since I believe most of these loans were negotiated during the period when rates were high, and the borrowers have no doubt been pleased by the fact that they have been able to take advantage of the decline in rates. The test will come when borrowers with such arrangements find themselves confronted with unexpected increases in rates on their term contracts.

I would also like to venture the guess that the prime rate is on its way out. I, for one, would like to see it go. The wide publicity given to changes in this rate almost force a kind of conformity when none may be warranted by the banks' underlying positions. Furthermore, while this conformity is initially brought about by competitive forces, it thereafter inhibits any price competition for the attractive loans falling in the "prime" category. There have been a few indications in recent years that the prime rate convention is on the way out - so-called "split prime rates" have persisted for limited periods, there are reports of declining numbers of loans actually being made at the prime rate, and increasingly we hear of loan rates tied to a marginal money market rate such as that on CD's or Eurodollars. I expect evolution in this direction to continue.

I would like now to discuss briefly a very significant trend in banking that has involved our big corporations very directly and which poses some serious problems for us in the future. I refer to those developments that have enabled our large corporations to escape, or at least delay, to a large degree, the impact of monetary restraint aimed at containing inflation. As you all know, this has been accomplished in a variety of ways. There has been the nailing down of huge amounts of funds through securing loan commitments from banks. There has been the whole package of devices that can be lumped together under "disintermediation", and there has been the ability of the multinational corporations to draw liberally on foreign sources of funds to meet domestic credit demands in periods

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of tight money. These are not necessarily banking "reforms", but they are certainly important changes in the way of doing business.

I personally am troubled about the problems these changes raise. Corporate management should share some of this concern. We have a system that is based on the assumption that we can stimulate or damp down economic activity by influencing the monetary aggregates. I have referred to my dislike of proposals that have been made to insulate particular sectors from the impact of monetary policy. We would like to be able to operate monetary policy in a nondiscriminatory manner, trusting that when it is necessary to contract that the squeeze will not impinge unduly on one sector or another. Unfortunately, things do not work out quite this way. We know that the housing as well as state and local government sectors are particularly vulnerable to tight money, and it now seems clear that the large corporate sector has been the most successful in escaping from its influence. Unless we can find good ways of correcting this imbalance, I am afraid that we are going to have a hard time avoiding having some bad solutions thrust upon us.

Banks should have learned from the 1966 and 1969 experiences the wisdom of adopting a more conservative policy with respect to loan commitments. Overwillingness to accommodate good customers in the past has been known to lead them into difficulties when it came time to deliver on commitments that had become excessively large. If the lesson has not been learned, some kind of direct intervention by supervisory agencies may evolve. For example, banks might be required to maintain throughout the cycle a somewhat higher average level of liquidity than has been typical in recent years.

If banks do tighten up in this area, you, as corporate borrowers, will be less able to nail down large commitments for use in periods of tight money. This may seem to be a drawback at first glance, but it will, I believe, contribute to a healthier situation for the business community and the economy as a whole in the long run.

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When such contractual obligations are uninhibitedly entered into, as they have been in recent years, the concentration of takedowns when credit becomes scarce, and the consequent bank efforts to meet their obligations, contribute to soaring interest rates, deteriorating conditions in securities markets, and inflationary pressures which persist painfully long even in the face of highly restrictive monetary policy actions. This is not in the best interests of the nation, its economy, or the business community.

I might add that those firms with foreign affiliates should not expect in the next go-round to easily escape U. S. credit restraints by international borrowing. The outlook is for more and more coordination among governments and central banks to moderate such international corporate maneuvering.

Of course, we are well aware of the fact that efforts to make monetary policy more effective by rules governing the banks can be frustrated by those who are able to circumvent the banking system. I am not sure just how this can be handled. Some think that it may be necessary to apply direct controls on the corporate borrowers, perhaps through establishment of a capital issues committee or a form of taxation. (These are not popular suggestions with those who dislike the proliferation of government controls over the private sector.) Others think that some system of selective credit controls might be desirable. (Our previous experiences with such controls have led some of us to the conclusion that they might serve a purpose for a short time during emergencies, but we would not like to see them adopted permanently.)

I will be frank to confess that in this area, that is of the greatest importance to you as corporate officers, I cannot provide any clear idea of what the ultimate solution will be. I would prefer to believe that the answer would lie in self-discipline and response to moral suasion, but perhaps that would be a little naive. And so I will only suggest that it is a problem of great interest and importance to all of us, and it deserves a great deal of

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thought. Knowing how ingenious corporate officers can be in devising ways to outwit the regulators, I would suggest that some of that ingenuity be applied to assisting us in devising better ways of spreading the impact and burden of monetary restraint more evenly and equitably throughout all sectors of our economy.

Our most recent experience in trying to cool down our overheated economy has shown that there is an excessive lag between the implementation of the overall restrictive policy and its impact on prices, wages and investment decisions. I do not think we can afford such long delays in the future. I personally believe that one cause of the difficulty is that the principal actors in the drama - government, business, labor and banking - have tended to work at cross purposes. There has been a noticeable lack of agreement on both goals and methods of achieving those goals. There has been some resemblance to a string quartet in which each person plays a different piece of music. We need to understand that we are all in this thing together and that we will get further if the various sectors will cooperate toward an agreed goal rather than work to frustrate each other. In order to achieve this we are going to have to develop better communication among all the sectors, but we are also going to have to accept the fact that ultimately it is the government that has to decide what music is going to be played by our economic string quartet. Once that decision is made, I would like to see the players do the very best they can to make the common effort a success. I believe that if we all work together in this spirit, we can make our policies work more effectively and more equitably. If we fail to do this, we are going to have solutions thrust upon us that will involve the kind of rigidity and coercion that all of us would like to avoid.

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