

For Release on Delivery:

10:40 a.m., Tuesday, May 21, 1957

"WHO SPEAKS FOR THE PUBLIC?"

Remarks

of

James K. Vardaman, Jr.

Member, Board of Governors
of the Federal Reserve System

before

66th Annual Convention

Illinois Bankers Association

St. Louis, Missouri

May 21, 1957

Morning Session

WHO SPEAKS FOR THE PUBLIC?

About six years ago Allan Sproul, then President of the Federal Reserve Bank of New York, and one of the really great men in Federal Reserve history, spoke here in St. Louis at the Golden Anniversary Convention of the National Association of Supervisors of State Banks. He chose as the title for his remarks "Who Speaks for Banking?". As usual, it was a profound address -- challenging and thought-provoking. One thing he said which particularly interested me was, to quote, "On the great issues of the times in the field of monetary and banking affairs, the banking community as a whole or at least in any organized capacity, usually has taken a negative or neutral attitude. It has left it to others to propose broad legislative programs and to devise changes in our banking and credit system. And then, in combatting flaws in such programs . . ., it has allowed itself to be cast in the role of opposition in resistance to change."

Since Mr. Sproul's talk and probably due in part to it, banking has spoken with a somewhat clearer voice than it had prior to 1951. This is certainly true with respect to some of the major economic questions of our day. Banking, as a whole, has given strong and well-reasoned support to sound monetary policies. However, in those areas more directly related to daily operational activities of banking its voice has at times been confused, selfish, and unbecoming, especially in relation to competition between independent banks and branch banks, and between commercial banking and other financial institutions such as savings and loan associations.

Bankers as a group or in convention assembled often appear to have a pathological fear of competition -- a kind of "competophobia". When such questions develop and are discussed, either privately or publicly, the voice of banking becomes strained, unnatural, and unconvincing. It is then that we hurt ourselves and our institutions by alienating support from the public and in the halls of Congress.

Banks as institutions, and bankers as individual citizens, should know what the public wants and requires; and should be first to recognize these requirements and govern themselves accordingly.

We, as bankers, are literally trustees of private enterprise, for without private banks there can be no private free-market system in this country. Private banking as an institution will survive only so long as it continues to serve the public adequately and fairly; and only so long as bankers take the high position of trustees, rather than the low position of money changers. Our behavior must be tempered by a high degree of public spirit and public service; and we should know that what is good for the public in the long-run is actually best for us.

In this capacity we must not be satisfied simply to defend our entrenched position; but must take the leadership in suggesting such changes in laws and regulations as will permit our banks to serve the public to the public's satisfaction. Whether we like it or not,

we should remember that the public will be served largely to its own liking, either by our present system or some other system of financial institutions. Already the erosion in the field of commercial banking has been heavy. The way to stop this erosion is not by static opposition but by constructive and progressive action, which will give the public facilities in the form of banking offices and banking services which the public requires.

Leaders in government and finance have suggested that this is a good time to take a careful look at the financial structure in the United States, and the relationships which have developed among various financial institutions. These proposals do not stem from any concern about the soundness of individual banks or loan companies, but they do express some feeling that competition among such organizations may be encouraging practices which, if not unsound in themselves may lead over time to unsound conditions in individual institutions. They refer to the intense competition now going on among commercial banks, savings banks, and savings and loan associations in certain areas which has expressed itself in upward adjustments in the rates paid for time deposits, window dressing around statement dates, longer banking hours, and flamboyant advertising.

Also, some observers appear concerned about the adequacy and effectiveness of present tools of monetary management. Others, impressed by the fact of a faster growth of other financial institutions than of commercial banks, seem concerned about the longer-run

competitive relations among the various organizations which make up the financial system; they believe that our mechanism of monetary policy requires commercial banks to carry more than their fair share of the burden of maintaining stability in the economy.

Still others are concerned about what seems to them to be an undesirable concentration of control over banking facilities in some areas through the proliferation of branches, the extension of chains and groups, mergers, or other similar arrangements.

If these and other similar questions are to be carefully examined and major changes in present laws governing financial institutions are to be considered, as now appears probable, it is more important than ever that commercial bankers speak plainly and bluntly, but with clear evidence of understanding of the public interest. This is possible only if we focus our attention on the basic needs and demands of the public -- which we all serve -- rather than on the narrow competitive interests of various financial institutions, which are transitory in nature.

First, it is important to remember that the present body of law which provides the basis for our financial structure was not developed capriciously. No field of Federal legislation has been more carefully thought out and less affected by narrow partisanship than banking law. Perhaps because the power "to coin money and regulate the value thereof" is a constitutional responsibility of the Congress, it has approached legislation in this field with great caution, and

the deliberations which have preceded important changes provide landmarks of true statesmanship in conduct of the legislative process. This was true of the National Banking Act, the Federal Reserve Act, and the Banking Act of 1935, which provide the statutory basis for most of our present arrangements. Certainly, this long tradition should be maintained, and modifications of the law with respect to banking should be made only after thoughtful, judicious consideration of what is best for the country as a whole. We may be confident that the Congress would prefer to approach financial legislation in this way and that it will seek and welcome our help.

We have a great and growing variety of private and governmental financial institutions, or financial intermediaries as they are sometimes called. Thus, we must deal with organizations ranging from commercial banks to the social security trust funds; from life insurance companies to mutual funds. While all of these institutions have something in common, they are in most respects very different from one another. In evaluating their importance, we must continually ask ourselves which of their similarities or differences are relevant to the question under consideration.

If we are interested primarily in those institutions that create liquid assets competitive with time deposits -- and perhaps to a lesser extent with demand deposits -- we can limit our attention mainly to mutual savings banks, savings and loan associations, and credit unions. Also, if we are concerned with the effect of

nonbank financial institutions on monetary policy, we probably should concentrate our attention mainly on these same organizations.

In considering the competitive relationship among commercial banks and between such banks and other financial institutions, we must always keep in mind that the commercial banks are in some respects unique. They create demand deposits, and this enables the commercial banking system as a whole to have an effect upon the economy that no other institutions can have. For this reason, as was discovered early in the history of banking, it is necessary for commercial banks to be subject to special regulations and supervision, and operational limitations not necessary for other financial institutions.

We all understand this when we take time to think it through. Sometimes, however, bankers tend to think in terms of the operation of their own separate banks, and it appears to them that they cannot create anything, but can only use the reserve funds brought in by their depositors. It looks to them as if their depositors control the amount of credit they are able to extend, since when deposits are withdrawn their bank loses reserve funds and has to reduce its earning assets.

But when we think in terms of the total financial structure and the role that banks play in it, we must remember the commercial banking system can create demand deposits, within the limits of its reserve funds. While depositors can alter the distribution of reserve funds among banks, and can cause embarrassment to bankers by shifting their deposits from one place to another, such shifts do not affect the total amount of reserves.

Control over the volume of reserve funds, as we know, is delegated by the Congress to the Federal Reserve System. We must frankly recognize that this is, and must always be, a sacred responsibility.

One thing that commercial bankers should keep in mind is this unique power — and the responsibility that goes with it — to create money through the medium of demand deposits. The great bulk of our money supply — about 80% — consists of demand deposits held only in commercial banks. There are in existence certain types of liquid assets that are in some respects similar to money, and the variety and relative amount of such liquid assets have greatly increased since the Second World War. It would be a mistake to overlook the importance of these funds; but it would be a greater mistake to equate them with money, and thereby discount the special place of money and, therefore, of commercial banks, in the financial structure of the country.

The Federal Reserve System carries out its mandate to regulate the amount of commercial bank credit or deposits, as we all know, through its control over the volume of bank reserves. The specific tools through which Federal Reserve policy is effectuated are primarily open market operations in U. S. Government securities and changes in Federal Reserve Bank discount rates, supplemented by occasional variations in the required reserve ratios of member banks.

The consensus seems to be that these instruments are sufficient to permit the Federal Reserve to achieve its objectives in regulating the volume of commercial bank credit and the money supply. Our experience over the past few years with an active anticyclical monetary policy has reinforced that opinion. There continue to be thoughtful students of finance, however, who believe that the Government should exercise a more rigid control over the money supply by requiring 100 per cent reserves against demand deposits.

Certainly, I do not approve any such extreme and it probably would not appeal to many of you; but, on the other hand, we should all be disturbed by the prospect of an opposite extreme as indicated in recent speeches and conversations which suggest that some people have lost sight of the responsibilities that commercial banks have to the public. They seem to feel that commercial banks should have an assured right to grow as fast as other financial institutions. The fact that laws and regulations prevent them from doing so constitutes, in their opinion, unfair discrimination. It has even been contended that it is discriminatory to apply to banks the special measures administered by the Federal Reserve System (particularly reserve requirements) without applying them also to other financial institutions. The suggestion is made that similar regulatory policies should be applied to such other institutions as savings banks, savings and loan associations, credit unions, life insurance companies, pension funds, and perhaps others.

Any approach that pretends that there are no significant differences between commercial banks and other financial institutions, or that ignores the fact that commercial banks are a part of the monetary mechanism of the country, cannot be sustained. Commercial banks are a special type of financial organization, and — in the public interest — they must be subject to special Governmental action that influences the volume of their assets and liabilities. Any proposal which does not recognize this basic fact is simply not sound and will not be considered seriously by the Congress.

When this has been said, however, we must also recognize that the commercial banks are competitive with some other financial institutions, particularly in their function of holding savings and time deposits, and in providing other financial services. The laws — especially tax laws — applying to other types of institutions affect to some extent their relative success in these competitive efforts. There is definitely inequity in some present tax provisions.

If savings and loan associations are growing more rapidly than commercial banks, should we apply additional regulations to savings and loan associations, or remove some from commercial banks, in an effort to equalize their potential growth factor? The unsoundness of such an approach is obvious.

What then, should govern the laws and regulations applicable to different financial institutions? The basic principle should be that the public interest must be protected. If commercial banks are

subject to any regulations not required to protect the public interest, then it is only good government to remove them. And if the regulations applicable to other institutions do not adequately protect the public interest, it is only good government to apply additional ones. This is the approach which bankers should take as trustees and leaders of the people in financial matters. In this way, bankers should speak for the public.

Although this approach is simple in concept, of course it is not simple in application. For it requires that we examine the role in the economy of banks and other financial institutions, and the environment in which we expect them to operate in the future, and then ask what regulations would make good economic sense and be good public policy.

In order to do this, we ought to consider how the obligations of the various financial institutions fit into the structure of financial assets existing in the economy. We ought to examine the relationship between the type of liabilities that each institution is pledged to meet and the type of assets that it holds. Do we find a proper balance between the structure of liabilities and the structure of assets? Are the operations of any class of financial institutions unsound in some sense and hence a threat to economic stability? What contribution are the various financial institutions making to the efficiency of our mechanism for mobilizing and allocating credit? Do they facilitate or hamper this all important function? Are they meeting

all of the needs that they could meet? Is each type of institution suited to the type of role that it is playing? At what points is our existing structure of laws and regulations deficient, excessive, or misguided? These are not easy questions, but they are the kinds of question that bankers should be asking -- and answering -- from the public's viewpoint as well as their own.

Financial institutions should not behave in such a way as to cause or contribute to economic instability. As one aspect of this, they should be managed on sound business principles and not be exposed to failure or undue risk of failure. At the same time, however, the useful services of all financial institutions should not be limited to dealings in the highest grade credit risks, but development of some institutions contributing funds to new and relatively risky undertakings should be encouraged. They should be allowed to adapt flexibly to changes both in the nature of demands for funds and in the preferences of savers. Therefore Government policies applicable to each type of organization should impose neither too much regulation nor too little, but should insure that each type is conducted in a way that is in harmony with the position that it fills in our over-all financial network.

This will entail continued application of special regulations to commercial banks. This is inescapable. The money supply must continue to be regulated in such a way as to minimize the risks of inflation and deflation, and thus contribute to the orderly growth

of the economy. This is no reason, however, to assume that the commercial banks are doomed to stagnation.

Over the longer run, if we believe in a growing economy, we must believe in the continued growth of commercial banking. Whether over the next decade commercial banks will grow more or less rapidly than other financial institutions is difficult to say. Many diverse factors affect the growth rates of such institutions as savings and loan associations, insurance companies, mutual investment companies, and pension funds. Basically they will be affected by changes in the preferences of the public for different types of financial services, by the types of credit demands and by the legal and regulatory framework within which they operate. That framework should be one that makes economic sense and does not discriminate against any particular type of institution. But it should not be and cannot be used as a means of protecting any institutions' "share of the market," or its assumed vested interests.

Given these underlying conditions the position of commercial banks in the financial structure of the country will be determined by the way in which bankers adapt to the changing needs of the economy. It is by having the imagination to see and the initiative to exploit the new opportunities for service uncovered by economic progress that bankers will insure the greatest possible growth for their organizations — not by trying to throw temporary roadblocks in the way of competing institutions, either other commercial banks, or savings and loan and similar financial corporations.

In view of the development of holding companies, chain-banking, the branching of savings and loan associations, and the establishment of an unusual number of single-unit banks, the question of branch banking, likewise, requires a fresh examination by the whole financial community, in the light of public needs and demands. Ours is a dynamic growing economy. Our population is increasing rapidly, and is constantly relocating in accordance with resource development. Rebuilding and expanding our cities, building of new cities, and the creation of new suburbia is a continuous and healthful process. Unreasonable statutory handicaps and obstacles to the provision of adequate commercial banking facilities for public service will be resented; and if commercial banks are not allowed to provide the needed services, in the form of conveniently located offices, and a wide variety of deposit, loan and trust facilities, our customers are likely to drift away to other institutions that will. Apparently some have already done so.

In providing banking services consistent with our ever developing economy, bankers can well do a little more living with the challenge of the future and a little less living with their competitive harassments of the past. The future of commercial banking does not lie in the successful defense of its established position, but rather in its willingness to meet the requirements and demands of the people and industries which it has been chartered primarily to serve.

In most of our communities the banker sets the standard of honesty, integrity, foresight, and prudence for the entire business

community. In this position of leadership, bankers, both as individuals and through their associations, must think through very carefully the needs of the country and of their communities and support those changes in the financial structure and its legislative base which will best serve the public.

It cannot be reiterated too often that commercial banking is unique among all private businesses in its association with the public interest. No other private undertaking carries with it the same degree of public responsibility. The voice of commercial banking must not be prompted by a narrow or selfish concern for banks as against other financial institutions; but by a sincere desire to encourage sound, constructive legislation -- which will permit commercial banks to serve better the legitimate demands of commerce and industry.

If the banking fraternity is to keep its position of leadership, it must thus speak for the public -- fairly, frankly and objectively.