

JAN 23 1979

REMARKS BY STEPHEN S. GARDNER
VICE CHAIRMAN
BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
AT THE
ANNUAL DINNER
FOR
NATIONAL ECONOMISTS CLUB
MARCH 4, 1976

GOOD EVENING. I AM HAPPY TO BE HERE. I RECENTLY JOINED ANOTHER EXCLUSIVE SOCIETY OF ECONOMISTS MYSELF. THEY ARE IN THE PROCESS OF THOROUGHLY CONFUSING ME WITH THEIR ERUDITION. BUT I AM PLEASED AND FLATTERED TO JOIN SUCH ABLE COLLEAGUES AT THE BOARD. HAVING BEEN USED TO HIRING ECONOMISTS IN PRIVATE INDUSTRY AND AT THE TREASURY, THERE IS SOME ROLE CHANGING HERE. I AM NOW BEING ORDERED ABOUT BY MEMBERS OF YOUR DISTINGUISHED FRATERNITY.

ALL THINGS CONSIDERED, THE ECONOMY IS GOING SURPRISINGLY WELL. THERE IS A CERTAIN CONSISTENCY IN THE EXPECTATIONS. WE'RE NOT HAVING AN ESOTERIC AND HEATED DEBATE ABOUT THE NEAR TERM. I TEND TO BE SURPRISED THAT THE INDICIES AND STATISTICS ARE CONTINUOUSLY POSITIVE ON BALANCE. THIS SURPRISE STEMS FROM WHERE WE WERE A YEAR AGO AND WHAT WE HAVE JUST BEEN THROUGH AND WHAT WE'RE STILL EXPERIENCING RATHER THAN ANY BASIC

DISAGREEMENT WITH WHAT THE GOVERNMENT IS DOING. THIS UNDERLINES THE FACT THAT THERE IS STILL CONSIDERABLE VITALITY IN THE PRIVATE SECTOR. BUT I AM MORE CONCERNED ABOUT THE ABILITY OF THE PRIVATE AND PUBLIC SECTORS TO MANAGE LONGER TERM PROBLEMS, SUCH AS ENERGY USES AND SUPPLIES AND ENVIRONMENTAL CONCERNS AND TO REINFORCE PRODUCTIVITY GAINS AS YOUR PRESIDENT, JOHN KENDRICK, POINTED OUT IN HIS SCHOLARLY STUDY ON ECONOMIC GROWTH AND TOTAL CAPITAL FORMATION FOR THE JEC.

BUT I DON'T INTEND TO TRY TO TELL THIS TALENTED AND THOROUGHLY PROFESSIONAL AUDIENCE ANYTHING ABOUT ECONOMICS. I DO INTEND TO TRY TO INTEREST YOU IN A PRACTICAL PROBLEM THAT IS INTEGRAL TO THE ECONOMY AND PROPOSES TO MAKE SOME SIGNIFICANT CHANGES IN THE MACHINERY BY WHICH MONEY AND CREDIT IS SUPPLIED TO THE PRIVATE SECTOR. WAY BACK IN 1968, IT WAS THOUGHT TO BE A GOOD IDEA TO STUDY OUR FINANCIAL INSTITUTIONS AND THE HUNT COMMISSION CAME INTO BEING A YEAR OR SO THEREAFTER. A GREAT DEAL OF STUDY WAS UNDERTAKEN WITH RATHER MODEST END RESULTS. ONE RESULT, THE FINANCIAL INSTITUTIONS ACT, WHICH ESSENTIALLY BROADENED COMPETITIVE POWERS OF VARIOUS FINANCIAL INTERMEDIARIES, WAS BROUGHT TO THE CONGRESS IN 1973. IT WAS SEASONED THROUGH SOME SENATE HEARINGS IN 1974 AND FURTHER

HEARINGS AND ACTION IN 1975. IN FACT, IT WAS PASSED BY THE SENATE 79-14 IN DECEMBER OF LAST YEAR. THE ACT ENVISIONED RATHER MODEST STRUCTURAL REFORM AND IT INCURRED BOTH PARTISAN SUPPORT AND OPPOSITION IN THE VARIOUS INDUSTRIES INVOLVED. PERHAPS THE MOST CONTROVERSIAL ISSUE WAS AND HAS ALWAYS BEEN THE ELIMINATION OF GOVERNMENT IMPOSED INTEREST RATE CEILINGS ON SMALL SAVINGS AND TIME BALANCES. TODAY, LESS THAN THREE MONTHS AFTER ITS PASSAGE, IT HAS DISAPPEARED INTO A SERIES OF PROPOSALS OF SWEEPING STRUCTURAL AND REGULATORY REFORM WHICH HAVE THE POSSIBILITY OF INCITING AS FIRERY A POLITICAL AND PARTISAN DEBATE AS OCCURRED DURING THE TERM OF ANDREW JACKSON WHEN THE SECOND BANK OF THE UNITED STATES WAS ABOUT TO GO THE WAY THE FIRST BANK OF THE UNITED STATES.

I AM SURE YOU HAVE NOTICED RECENT PRESS STORIES. IS THE BANKING SYSTEM SOUND? WHICH, OF COURSE, IT IS. CAN THE REGULATORY STRUCTURE BE IMPROVED? WHICH, OF COURSE, IT CAN. SHOULD WE ATTEMPT TO DO THIS TOMORROW, IN ALL ITS COMPLEXITY? I HONESTLY SUGGEST WE SHOULDN'T. ONE OF THE PROBLEMS IN DISCUSSING THE SPECIFIC LEGISLATIVE INITIATIVES THAT ARE INCORPORATED IN THE BILLS BEFORE THE SENATE AND THE HOUSE, IS THAT

INEVITABLY ONE COULD AGREE WITH A NUMBER OF THE PROPOSALS AS INDIVIDUAL ISSUES. ANOTHER MINOR PROBLEM IN THIS COURSE IS THAT I AM A MEMBER OF A BOARD OF GOVERNORS THAT WILL MAKE AN OFFICIAL STATEMENT OF THE SPECIFICS PROVISIONS OF THE LEGISLATION AND THE BOARD HAS NOT COMPLETED ITS DELIBERATIONS. FURTHERMORE, IF I TALK TO YOU ABOUT ALTERNATIVES TO SOME PROPOSALS AND ENDORSE OTHERS WITHOUT CHANGE, WE'LL MISS AN OPPORTUNITY TO REFLECT ON THE WHOLE SYSTEM AND THINK A LITTLE BIT ABOUT THE IMPACT OF THE PLAN ON OUR ECONOMY, AND WE CERTAINLY COULD BE SO CAUGHT UP IN THE COMPELLING LOGIC OF THOSE WHO ARGUE FOR CHANGE, THAT WE COULD MISS A REASONABLE AND THOROUGH ANALYSIS OF THE RECORD AND VIABILITY OF OUR PRESENT SYSTEM OF FINANCIAL INTERMEDIARIES.

I THINK IT IS WELL DOCUMENTED THAT THE UNITED STATES BANKING SYSTEM IS QUITE UNIQUE IN THE WESTERN WORLD AS CONTRASTED WITH THE BANKING SYSTEMS OF OUR TRADING PARTNERS. IT IS HIGHLY DIVERSE IN TERMS OF SIZE, FUNCTIONS AND NUMBERS, WITH OVER 14,000 BANKS RANGING FROM VERY LARGE MULTI-NATIONAL CORPORATIONS TO SMALL LOCAL BANKS SERVING COMMUNITIES IN ALMOST EVERY TOWN OR CITY. THE AVERAGE DEPOSIT SIZE OF A BANK IN THE UNITED STATES RANGES BETWEEN 10 AND 25 MILLION, AND THIS

IS ACTUALLY A VERY SMALL FINANCIAL INSTITUTION. OVER 300 OR MORE NEW BANKS ARE USUALLY FORMED EVERY YEAR WHILE ABOUT THE SAME NUMBER ARE ACQUIRED BY OTHER BANKS OR DISAPPEAR INTO HOLDING COMPANIES. WHILE WE HEAR CONCERNS EXPRESSED ABOUT THE CAPITAL ADEQUACY OF THE BANKING SYSTEM GENERALLY, TYPICALLY THE AMERICAN BANK HAS BEEN REQUIRED TO HAVE A MUCH STRONGER CAPITAL RATIO TO DEPOSITS OR TO LOANS AND INVESTMENTS THAN THE BANKS IN BANKING SYSTEMS OUTSIDE OF THE UNITED STATES. DEPOSITOR INSURANCE IS AN AMERICAN INNOVATION. VERY FEW COUNTRIES PROVIDE COMPARABLE PROTECTION. CHECKING ACCOUNTS, AS WE KNOW THEM, ARE MUCH MORE EXTENSIVELY USED, READILY AVAILABLE, AND MORE SUBJECT TO PRICE COMPETITION HERE THAN IN OTHER NATIONS. AMERICANS HAVE GREATER ACCESS TO CONSUMER CREDIT BOTH THROUGH THE BANKING SYSTEM AND NON-BANK FINANCIAL INTERMEDIARIES THAN MOST PEOPLES OF THE WORLD. PERHAPS THIS IS THE REASON OUR CITIZENS SAVINGS ARE A SMALLER PERCENTAGE OF GNP THAN IN OTHER DEVELOPED NATIONS. FURTHER, TRUST SERVICES, AS WELL AS MANY OTHER FORMS OF BANKING SERVICE, ARE GENERALLY MORE AVAILABLE HERE THAN ABROAD TO THE AVERAGE CONSUMER.

HAVING VIEWED THE EVOLUTION OF MUCH OF WHAT I HAVE DISCUSSED OVER 25 TO 30 YEARS, I WOULD SUGGEST THAT THERE HAS BEEN SIGNIFICANT PROGRESS IN THE DEVELOPMENT OF BANKING SERVICES.

THIS IS PROBABLY CHARACTERISTIC OF A COMPETITIVE INDUSTRY WHERE THERE ARE MANY SMALL UNITS. IT IS UNCHARACTERISTIC, HOWEVER, IN MY OPINION FOR ANY INDUSTRY THAT IS SUBJECTED TO STRONG FEDERAL AND STATE REGULATION. I SUSPECT THAT THE EVOLUTION IN BUSINESS AND INDIVIDUAL DEMANDS FOR BANKING SERVICES, THE INCORPORATION OF NEW TECHNOLOGY, AND THE FACT THAT MAJOR CHANGES IN THE REGULATORY STRUCTURE HAVE OCCURRED ONLY PERIODICALLY AND THEN WHEN IT APPEARED WISE FOR THE CONGRESS AND THE STATE LEGISLATURES TO ADDRESS AN IMPORTANT PROBLEM, HAVE BEEN RESPONSIBLE FOR THIS RATHER UNUSUAL RESULT. IN OTHER WORDS, SIGNIFICANT REGULATORY CHANGE HAS EVOLVED IN MUCH THE SAME WAY THAT THE INDUSTRY ITSELF HAS EVOLVED, SPURRED ON BY THE CHANGING NEEDS OF OUR SOCIETY.

SOME OF THE MOST FUNDAMENTAL CHANGES IN OUR REGULATORY PROCESS WERE MADE FOLLOWING THE FINANCIAL DISASTER THAT OCCURRED IN 1929. I WISH WE HAD THE TIME HERE TO PUT THAT PERIOD IN PERSPECTIVE. THE ACTIONS TAKEN THEN TO EXPAND THE REGULATORY AGENCIES' POWERS AND ESTABLISH THE FEDERAL DEPOSIT INSURANCE CORPORATION WERE SOUND. FOR MORE THAN 40 YEARS THEREAFTER, BANK FAILURES HAVE BEEN UNCOMMON EVENTS AND OF DE MINIMIS IMPORTANCE TO THE ECONOMY. THE STRAINS THAT THE BANKING SYSTEM HAS UNDERGONE IN RECENT YEARS,

DO NOT BEGIN TO COMPARE IN SEVERITY WITH THE PROBLEMS OF THE EARLY THIRTIES. THE FEDERAL DEPOSIT INSURANCE SYSTEM, IN FACT, HAS BEEN SO EFFECTIVE THAT ALMOST WITHOUT EXCEPTION BOTH INSURED AND UNINSURED DEPOSITORS HAVE NOT LOST MONEY IN A MODERN BANK FAILURE.

I DON'T WISH TO OVERLOOK THE RECENT DIFFICULTIES IN THE BANKING SYSTEM. I JUST WANT TO PUT THEM IN PERSPECTIVE. THERE HAS BEEN GROWTH, COMPETITION HAS BEEN INCREASED NOT DIMINISHED, INNOVATION HAS BEEN A CHARACTERISTIC OF THE SYSTEM, AND THE ACTUAL NUMBER OF FAILURE HAS BEEN MINIMAL.

THE POINT I WOULD LIKE TO MAKE IS THAT GROWING OUT OF THE SENSATIONALIZED REVELATIONS ABOUT THE DECLINE IN ASSET QUALITY OF SOME OF OUR BANKS, WE ARE APPARENTLY DRIVING FORWARD WITH SOME PHILOSOPHICALLY CONTRADICTORY PROPOSALS WITHOUT HAVING REACHED A CONSENSUS ABOUT WHAT IS WRONG WITH OUR BANKING SYSTEM. IN MY OPINION THE COMPREHENSIVE LEGISLATION CONGRESS IS CONSIDERING IS REplete WITH LOGICAL INCONSISTENCIES. FOR EXAMPLE, COMPETITION, WHILE, AT LEAST SINCE THE 1930'S, CONSTRAINED BY THE BANKING LAWS OF BOTH THE STATE AND THE FEDERAL GOVERNMENT, LAWS THAT WERE ORIGINALLY DRAFTED TO PROTECT DEPOSITORS FROM A MASSIVE NUMBER OF

SPECULATIVE FAILURES EXPANDED EXTRAORDINARILY IN THE POST-WAR YEARS. IT COULD EASILY BE CONSTRAINED AGAIN BOTH BY A MONOLITHIC FEDERAL BANKING COMMISSION AND AN INQUISITION INTO WHY THE QUALITY OF BANK ASSETS SUFFERED IN THE MOST DRAMATIC RECESSION SINCE THE 30'S. THE PRESENT REGULATORY SYSTEM DOES ENCOURAGE COMPETITION IN ADDRESSING CHANGE, I HAPPEN TO THINK THATS DESIRABLE.

A COROLLARY OF THE CRITICISMS BEING LEVELLED AT THE REGULATORS IS THE DEMAND FOR MORE INFORMATION ABOUT THE REGULATED. THERE IS NO INDUSTRY IN OUR ECONOMY TO MY KNOWLEDGE THAT IS VISITED ANNUALLY OR BIANNUALLY BY TROOPS OF FEDERAL AUDITORS CONDUCTING VOLUMINOUS EXAMINATIONS ON EVERY PART OF ITS BUSINESS. IN ADDITION, AS PUBLIC CORPORATIONS BANKS ARE SUBJECT TO ALL THE DISCLOSURE REQUIREMENTS OF THE SEC. THE BANK STOCK ANALYSTS TELL US THEY KNOW MORE ABOUT THIS INDUSTRY AND THE FIRMS IN IT THAN ANY OTHER PUBLIC CORPORATIONS.

INDIVIDUAL PRIVACY IS HARDLY EVER MENTIONED IN THE CURRENT DEBATE. OUR GOVERNMENT IS CONSCIENTIOUSLY AND INDUSTRIOUSLY ENACTING LAWS AND REGULATIONS TO ASSURE THAT INDIVIDUALS RETAIN THEIR PRIVACY IN OUR SOCIETY. YET THE BOOKS AND RECORDS OF BANKING INSTITUTIONS CONTAIN THE MOST INTIMATE FACTS ABOUT THE FINANCIAL AFFAIRS OF MOST OF US AND OUR BUSINESSES AND IT IS OF COURSE A CONTRADICTION TO FIND DEMANDS BEING MADE FOR DISCLOSURE OF THESE FACTS WHEN THE SUBJECTS

OF THE INFORMATION HAVE PRESENTLY NO PROTECTION FROM THE PROCESS.

ANOTHER PARADOX, OF COURSE, IS THE DUAL BANKING SYSTEM. STATES HAVE RESERVED TO THEMSELVES THE RIGHT TO DETERMINE GENERALLY THE COMPETITIVE STRUCTURE OF BANKING WITHIN THEIR BORDERS. THIS IS CURIOUS IN AN INDUSTRIALIZED NATION THAT GENERALLY PERMITS THE FREE FLOW OF COMMERCE NATIONWIDE. THE ISSUE IS NOT DIRECTLY ADDRESSED IN THE NEW PROPOSALS AND PERHAPS IT SHOULD BE. FOR IT ALSO SEEMS TO ME THAT A POWERFUL ICC TYPE FEDERAL REGULATOR IS LIKELY TO DIMINISH THE EFFECTIVENESS OF THE STATE REGULATORS.

I THINK IT IS ALSO TRUE THAT THE PRESENT FEDERAL RESERVE SYSTEM, WITH ITS TWELVE REGIONAL BANKS AND 25 BRANCH OFFICES, HAS A UNIQUE ABILITY FOR EVALUATING THE DIFFERING ECONOMIC CLIMATE AND NEEDS IN THE VARIOUS INDUSTRIAL AND AGRICULTURAL SECTORS OF THE COUNTRY. FEDERAL RESERVE SYSTEM BANKS AND BRANCHES HAVE CAREFULLY STRUCTURED BOARDS OF DIRECTORS WITH PUBLIC MEMBERS, BUSINESSMEN, AND BANKERS FROM EACH REGION PLAYING AN IMPORTANT ROLE IN THE OPERATIONS AND POLICY DELIBERATIONS OF THE SYSTEM. THIS IS AN IDEAL FORM OF FEDERAL GOVERNMENT PARTICIPATION IN NATIONAL POLICY. IF THE ROLE OF REGULATING AND EXAMING THE LARGE BANKS AND HOLDING COMPANIES IN THE COUNTRY IS TAKEN FROM THE SYSTEM A DUPLICATE

REGIONAL SYSTEM OUGHT TO BE RECREATED WHICH IS RIDICULOUS.

THERE ARE MANY THINGS THAT NEED ATTENTION AND THERE ARE RESPONSIBLE PROPOSALS BEFORE THE CONGRESS INCLUDING THE ORIGINAL FINANCIAL INSTITUTIONS ACT, THE PROPOSALS TO STRENGTHEN THE POWER OF THE PRESENT REGULATORS, THE PROPOSALS TO EXTEND NATIONAL REGULATION TO FOREIGN BANKS IN THE UNITED STATES, AND THE PROPOSALS TO IMPROVE BY STATUTE THE COORDINATING ACTIVITY THAT EXISTS BETWEEN THE PRESENT FEDERAL REGULATORS. BUT COMBINING THESE PROPOSALS INTO A MASSIVE BILL OR SERIES OF BILLS THAT WOULD CONCENTRATE AN EXTRAORDINARY GROUP OF POWERS IN ONE AGENCY WITH A MISSION THAT WILL INEVITABLY, IN MY JUDGMENT, HAVE ANTI-COMPETITIVE EFFECTS SEEMS THE WRONG WAY TO GO ABOUT THE FIRST MAJOR FEDERAL REGULATORY REFORM SINCE 1933.

MY COLLEAGUES AT THE FEDERAL RESERVE HAVE ALREADY TESTIFIED THAT REMOVING ALL REGULATORY AND EXAMINATIONS FUNCTIONS FROM THE FEDERAL RESERVE WOULD DIMINISH THEIR ABILITIES TO MANAGE MONETARY POLICY. I BELIEVE THIS AND HAVE SO INDICATED IN TREASURY TESTIMONY. I THINK THE OVERSIGHT OF THE MAJOR BANKS AND BANK HOLDING COMPANIES WHICH THE FEDERAL RESERVE POSSESSES IS A VERY SIGNIFICANT AID TO THE DEVELOPMENT OF MONETARY POLICY BECAUSE IT KEEPS THE FEDERAL RESERVE UNIQUELY IN TOUCH WITH CREDIT POLICY AND TRENDS. I ALSO THINK

THAT WITHOUT REGULATION AND EXAMINATION RESPONSIBILITIES
THE VITALITY OF THE REGIONAL BANKING SYSTEM OF THE FED WOULD
WHITHER.

IF ONE IS LOOKING FOR A FINAL PARADOX IT WOULD SEEM
TO ME THAT WE, AS A SOCIETY AND IN BOTH CONGRESS AND THE
ADMINISTRATION HAVE BEEN ENCOURAGING THE PRIVATE BANKING
SYSTEM TO SUPPORT AND CONFORM WITH THE EMERGING SOCIAL
AND ECONOMIC GOALS IN THIS NATION AND I THINK THAT HAS LARGELY
HAPPENED. SOME OF THE PROPOSALS BEFORE THE CONGRESS TODAY
COULD HAVE THE OPPOSITE EFFECT AND I'M SIMPLY URGING THAT
YOU TAKE AN INTEREST IN THE CONTROVERSY AND BECOME FAMILIAR
WITH THE LEGISLATION. A VIABLE CENTRAL BANK AND BANKING SYSTEM
ARE ESSENTIAL TO THE HEALTH OF AN ECONOMY.

AT ANOTHER TIME WHEN THE BANKING SYSTEM WAS AT ISSUE
AND THE WHOLE COUNTRY WAS ENMESHED IN A VIOLENT POLITICAL
DEBATE, ANDREW JACKSON WROTE TO THE SECRETARY OF THE
TREASURY

"THERE IS JUST GROUND TO FEAR, THAT IN
THE CREATION OF A SUBSTITUTE, AS GREAT DANGER,
IF NOT GREATER, MAY BE INCURRED, AS THAT WHICH
NOW THREATENS THE AMERICAN PEOPLE."

JACKSON WAS DEAD WRONG ON THE ISSUE AND WE HAD
FINANCIAL PANIC AFTER FINANCIAL PANIC FOR FIFTY YEARS FOLLOWING
HIS REFUSAL TO RENEW THE CHARTER OF THE 2ND BANK OF THE
UNITED STATES.

BUT I LIKE THE QUOTE.