FROM:
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ADDRESS OF M. MONROE KIMBREL

President, The American Bankers Association, before the South Dakota Bankers Association, Elks Club B.P.O.E. #838, Watertown, Saturday, May 18, 1963. Mr. Kimbrel is chairman of the board, First National Bank, Thomson, Ga.

In every industry there comes a time when concerted efforts at "taking stock" are in order. We in banking provide no exception to this rule. The splendid Centennial activities in which all of us are engaged provide an ideal opportunity for reviewing the past, for recognizing our mistakes, and for building on our successes. Surely, in this process of review, we can allow ourselves the luxury of pointing to the economic progress which has been underwritten by the nation's banks. At the same time, we also should measure the dividends which have accrued to the banking industry as a result of its investment in economic progress.

We can be proud of our past achievements, but we cannot be complacent about them. We will do ourselves a disservice if we fail to recognize the challenge of the future. For our future is only as secure as we make it. And our ability to thrive is conditioned on our dedication to the free-market principle that the success of business institutions stems from the efficient performance of useful functions.

It often is said that the future belongs to those who earn it. In a free-enterprise society, it is worth remembering that neither commercial banking nor any other group can claim an inherent right to grow, to remain healthy and prosperous, or to participate in the nation's over-all economic advance. Such rights do not exist.

Virtually all businesses seek to grow, and there are few banks that do not have growth targets. Yet, unlike other businesses, the aggregate supply of the product which banks have to offer--bank credit--is subject to effective control by the nation's monetary authorities; and the total volume of demand deposits held in commercial banks is likewise closely regulated. Whether the volume of demand deposits grows 10, 20, or 30 per cent over the next decade depends not on the competitiveness of commercial banks or the efficiency of their operations, but rather on the decisions of monetary authorities as to what rate of increase will best serve the interests of sustainable economic growth.

Within these limits of monetary growth established by monetary authorities, individual bank competition for a larger share of the total supply of demand funds merely leads to a reallocation of the existing money supply among the nation's banks.

As an industry, we reconcile ourselves to the need for economic stability and to the necessity for close Government control over the total amount of demand deposits available for spending. But at the same time, we, as individual bankers, also endeavor--each of us in our own way--to capture a larger share of the demand deposits available.

In recent years, competition for loanable funds has grown increasingly sharp among the nation's banks--and this is not surprising. During much of the postwar period, the emphasis in banking was on the diversion of investment funds into loan channels, and the lending capacities of commercial banks were not so directly dependent upon their ability to attract new deposits. However, the process of unwinding the heavy portfolios of Government securities acquired during wartime led to a steady reduction in bank liquidity, and by the latter part of the 1950's most commercial banks had begun to feel fairly

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serious liquidity pressures. Since that time, expansion in the lending capacity of individual banks has been determined to a large extent by their competitive success in attracting new deposits, and the result has been an intensified drive among banks for increasing their share of the demand-deposit market.

In competing for these funds, bankers have been active in providing additional services for their corporate customers. Some of these services pay their own way; some do not. Although many other factors have been important in explaining the increase in bank costs, one element in the picture has been the competitive pressure for offering new bank services at less than costs.

At this point, I might add that I am puzzled at times when I hear bankers talking about offering services at cost. It seems to me that we should offer services at a price that will add to net earnings. Costs, of course, are a factor. But many of us have gotten into the habit of using the terms "cost of service" and "price of service" interchangeably. We can perform a million new services at cost without increasing earnings by one nickel.

Looking again at the industry as a whole, the introduction of additional banking services at cost or less than cost adds to the costs of banking while, at the same time, it does not increase the volume of demand deposits or provide the means through which these funds may be invested more profitably. There are elements for concern here. Banking must remain on guard against tendencies for the persistent addition of cost-raising services which add neither to the resources nor to the income of the industry.

Looking ahead, there is little prospect that the earnings position of commercial banks will be strengthened significantly--if at all--by significant increases in their demand balances. It does appear reasonable to expect that demand deposits over the foreseeable future may expand, on the average, at a

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rate of somewhere near three per cent per year. But such an increase should not lead us to conclude that rising bank costs can be met from the revenues generated by demand-deposit expansion alone.

Moreover, we do not have the opportunities today, as we did in the early postwar period, for strengthening our earnings position by converting a substantial volume of low-yielding Government securities into higher-yielding loans. All bankers must look more closely at the allocation of their assets, and satisfy themselves that earnings are being sought in a manner which is consistent with responsibilities for the safety of depositors' funds.

Even with significant gains in gross earnings stemming from improved asset allocation and moderate expansion in demand deposits, the problem of rising bank costs is likely to continue to plague us. If we don't want the pressure of these costs to jeopardize the strength of our industry, we must seek remedies in a number of areas. Let's consider a few of them.

First, commercial banks may become increasingly active in the savings field by capturing a larger share of the savings funds now held by such thrift institutions as savings and loan associations and other nonbank financial institutions. These are higher-cost funds than demand deposits, of course, but since they are relatively stable, we can put them to work in markets which provide a much higher rate of return.

Many people have the impression that savings funds are inherently less profitable than demand deposits--a view which over-all banking statistics appear to support. These statistics show that the higher the proportion of time and savings deposits to total deposits, the less profitable the bank is likely to be.

It is important to note, however, that a breakdown of these statistics shows that the totals are heavily weighted by the large number of banks which manage their savings funds more or less in the same way as they lend and invest their demand deposits. Obviously, under these circumstances, savings funds tend to be unprofitable. Yet, opportunities for the profitable employment of savings funds are not lacking, and the profitable employment of these funds requires only that commercial banks employ them in those markets for which they are particularly suitable--including, most notably, consumer and mortgage lending.

If we are to concentrate more heavily on the savings markets than we have in the past, perhaps we should also turn our attention to regulatory and institutional arrangements which complicate the task of competing with nonbank institutions for savings funds. Tax inequality, of course, represents perhaps the most serious barrier to our effectiveness in competing with nonbank savings institutions. While considerable progress has already been made in reducing the disparity in competitive opportunities between commercial banks and other types of financial intermediaries, there is still much room for improvement.

In addition, some attention must also be given the system of reserve requirements against savings funds held in banks and in competing institutions. If savings inflows into commercial banks are relatively stable and represent genuine long-term savings, what is the logic underlying the existence of a financial system in which these savings flows into commercial banks produce a different monetary impact than savings flows to other thrift institutions? Increases in time and savings deposits at commercial banks lead to a reduction in the volume of demand deposits, whereas the build-up of savings funds in other types of financial institutions does not. In this area alone, are there not important points to be analyzed and developed by the banking industry?

Fortunately, some inquiries along these lines are now being made. Many of you know, I am sure, that the recent report of the President's

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Committee on Financial Institutions--the so-called Heller Committee--requirements which now apply against commercial bank time and savings deposits be made applicable to shares at savings and loan associations and to deposits at mutual savings banks. If this recommendation were adopted, it would eliminate one handicap which banks face in competing for savings funds. However, there are other considerations which suggest that the recommendation, on balance, must be subject to extended appraisal before the representatives of organized banking can comment in detail on its over-all desirability.

Aside from the need for more vigorous competition in the savings field, bankers must also exercise considerable care in developing cost control programs which will enable them to determine with accuracy the expenses involved in providing specific services for their customers. If banks are to maintain adequate profit margins, the new bank services now being offered our customers must pay their own way. This means that individual banks must be in a position to appraise the expenses involved in offering new attractions for bank depositors, and that they must also be able to sell their customers on the reasonableness of the charges imposed.

Finally, it should be noted that the adequacy of bank earnings--and the future prospects for banking growth--are closely intertwined with the level of reserve requirements imposed by Federal Reserve authorities against demand deposits. Reserve requirements cannot be varied, it is true, for the purpose of influencing bank earnings. However, the level at which they are fixed does exert an influence on the ability of the banking system to show a reasonable rate of return on invested capital, and these considerations cannot be ignored.

In the long run, public policy can ill afford to ignore either the issue of the adequacy of bank profits or the implications of developing cost pressures for structural characteristics of the banking system. Lower reserve requirements against demand deposits in commercial banks would permit substantial earnings relief for an industry whose total size is regulated closely by monetary authorities. Such a reduction would allow banks to shift part of their assets out of nonearning balances with the Federal Reserve banks and put these funds to work so they would make a contribution to bank profits.

The American Bankers Association takes the position that reserve requirements against demand deposits should be reduced gradually to a level of ten per cent. Such a move would materially enhance the strength of the banking system and contribute to the brightness of its future.

In banking, as in few other fields, the prospects for our growth depend heavily upon the wisdom with which Government regulatory policies are applied. I am personally convinced that, within the framework of appropriate public-policy regulation, we can contribute to the national well-being while at the same time adding to the vigor and growth of our own industry. And I do not believe there is any self-interest in my conviction that regulatory policies which unduly hamper the growth of the banking system are also contrary to the national interest. To the extent that banking is restricted, other types of lenders will assume an increasingly active role in the nation's finances.

In my judgment, we should avoid the further cultivation of a financial system in which an increasing proportion of credit extension is in the hands of specialized, single-purpose lenders, while a declining proportion is in the hands of multi-functional lenders such as commercial banks. Such a development interferes with the efficient allocation of credit among different types of borrowers.

In closing, I would reemphasize my belief that banks will thrive and prosper only so long as they provide useful services in an efficient way. I am confident that we can do so and, in the process, build on the record of progress and achievement which has marked our past.

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