

An Address by
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Four Forces for Intensified Competition
in
Retail Banking

Before the
61st Annual Convention
Bank Marketing Association
Hotel Fontainebleau
Miami Beach, Florida

October 27, 1976

Four forces are at work in our economy and society--all of which promise to increase the level of competition in retail banking. Some of these have already impacted the New England banking scene, creating throughout New England the most competitive retail banking environment in the United States.

The first of these is a fundamental change in thinking in the Congress on banking law. We emerged from the 1930's with a set of banking laws which had gradually evolved over the preceding hundred years and reflecting two principal doctrines. The first of these was that competition should be restricted geographically; the second that price competition, although encouraged in most industries, should be restricted in banking. The support for both of these doctrines is clearly diminishing in the Congress.

The prime thrust behind limiting competition geographically, prohibiting branching across state lines and limiting branching within states, was to avoid a national concentration of power in banking. This objective was realized. We have the least concentrated

banking system of any major industrial country, but this objective has been attained at the expense of limiting competition in many ways. Without abandoning the objective of avoiding excessive concentration in banking, it seems clear that the Congress is drifting toward the easing of geographic barriers to competition.

A mythology has developed that restrictions on price competition in banking were the result of a conviction that, if banks were to engage in price competition for deposits, they would be forced into high-risk investments and the banking system would be rendered vulnerable to any weakening in the economy. Actually, as Carter Golembe has pointed out, the prohibition of the payment of interest on demand deposits was the consequence of a political trade-off made in the early 30's to get the commercial banks to accept deposit insurance, the premium for which was extremely expensive relative to the rate of return on bank assets in the early years.

It seems to me that we are moving inexorably in the direction of the payment of interest on demand deposits nationally. This will not only intensify competition, but change the way in which it is manifested. In any industry in which price competition is limited, competition tends to be reflected in the giving away of services. Banks will have to adapt to an environment

in which they pay for all deposits by charging for the services which they have been giving away. This adaptation will be painful, but in the end it will result in a more rational use of bank services by the consumer. You do not need to be a trained economist to realize that services priced at zero are likely to be overused.

It is interesting to note that the reaction of the Congress to the problems which appeared in the banking industry in 1974-75 was not to weaken the thrust toward more competition in banking, but rather to urge bank regulators to adopt a tougher stance in bank supervision. This suggests that the thrust in the Congress toward measures to break down barriers to competition in banking is deep-seated.

The second force for intensified competition in banking is the consumer movement. Up to the moment, the consumer movement has been primarily concerned with matters such as Truth-in-Lending and discrimination in lending. These measures may have increased costs, but they probably have had little impact on the level of competition. It is in the preservation of the NOW account that the consumer movement has, thus far, had the greatest competitive impact. When the Congress was first asked to deal with the NOW account, it found that both the commercial banks and the savings and loan associations were opposed

to its survival--a formidable combination. Among financial institutions, only the mutual savings banks supported it. It was because the Congress viewed the NOW account as a consumer issue that it survived in New England. A consumer issue for the future which could have a major impact on competition in banking is the treatment of the small saver under Regulation Q. The effect of Regulation Q has been to subsidize the home buyer at the expense of the small saver. The small saver has never had an effective champion in matters appearing before the Congress, but perhaps his day is coming.

The third force for increased competition in retail banking is the entry of the thrift institutions into the payments mechanism. In New England, where this trend is much further advanced, competition between commercial banks and thrift institutions is at a much higher level than ever before. The old "live and let live" philosophy, which was reflected in New Hampshire and some other areas of New England in commercial banks and savings banks sharing common lobbies and often common management, is gone forever. New England thrift institutions can now offer the full range of banking services to the consumer, and they see their salvation in their ability to compete across the full range. Not unnaturally, the thrift institutions want also to keep the special privileges which were given to them when they were special purpose institutions. As

things stand in New England, the thrift institutions have been given new tools with which to compete with commercial banks but are still sheltered from the price competition of commercial banks by Regulation Q, but this competitive shelter may not be long-lived.

The fourth source of intensified competition will be electronic funds transfer. This new technology will probably do more to change the face of banking in the years ahead than any of the other forces we have been discussing. The nature of the increased competition stemming from electronic funds transfer will be determined, in part, by the framework of law which the Congress imposes upon it. One thing seems certain, the capability that electronic transfers offer to cut the cost of a transfer substantially below the cost of a paper transfer means that the bank with the capability to put this new technology in place ultimately will have a substantial competitive edge over banks that are confined to the paper transfer.

In summary, the changing Congressional attitudes toward restrictions on geographic and price competition among commercial banks, the growing influence of the consumer movement, the movement of the thrift institutions into the payments mechanism and the potential of electronic funds transfer all promise, in varying ways, to intensify the level of competition in retail banking in the years ahead.