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A Heritage Roundtable

Interstate Banking: How Much, How Fast?

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March 23, 1985
The Louis Lehrman Auditorium
The Heritage Foundation

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ISSN 0272-1155
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Interstate Banking: How Much, How Fast?

Edwin J. Feulner, Jr.: Good morning, ladies and gentlemen. My name is Ed Feulner. I am the president of The Heritage Foundation. On behalf of my colleagues, it is my pleasure to welcome you this morning to our seminar on the broad subject of: Interstate Banking: How much, How fast?

It is clear as we address this subject that there are not only very diverse points of view regarding it, but it is also clear that events are occurring very rapidly in this area. The fact is we do see interstate banking variously; through different loopholes, through the establishment of so-called nonbank banks, through other nontraditional bank institutions becoming in effect at least partial services banks.

So, this being the direction in which we are moving, what we hope to do today is cast a fair amount of light on the subject, (perhaps even a little bit of heat as well, but more light than heat, we hope) from differing perspectives: from the perspectives of the small independent bankers, the perspectives of the major bankers, and from at least one very distinguished academic intellectual who does not have to worry about practical matters.

Each of our four speakers will be given 15 minutes for an opening statement. After that we will come back for about a three minute response from each person, and then we will open up to general discussion.

The order of our speakers this morning will be Ken Guenther, followed by Catherine England, then Bill Dabaghi, and finally Ed Shaw.

Ken Guenther, our first speaker, is an old Washington hand. He formerly served as assistant to the Chairman of the Board of Governors, reporting directly to Burns, Miller, and Volcker (presumably seriatim, not simultaneously). He also served in the White House under President Ford and in the Treasury Department when Secretary Shultz was Secretary of the Treasury, prior to which he served on Capitol Hill as the economic assistant to Senator Jacob Javits who, as many of you will recall, was very active in the Joint Economic Committee and other major economic entities in the United States Senate. He is now the staff head of the 7,500 member Independent Bankers Association, and has been there for the last four years.

Kenneth A. Guenther: Let us think back a little less than four years and six

months ago. It was between Christmas 1980 and New Year's 1981, to be exact. The White House staff, in Jimmy Carter's name, released a position paper on geographic deregulation. This study had been mandated by the Heinz Amendment to the International Banking Act, an act that imposed national treatment on foreign banks operating in this country; an act that imposed the McFadden Act and the Douglas Amendment on foreign banks; an act that was the last major expression of the U.S. Congress on the laws that are the foundation of our diversified financial structure. I say that the White House staff released the report as President Carter had lost interest in this and other matters after his November 1980 defeat.

The report was interesting. Its primary recommendation was to liberalize the Douglas Amendment to allow interstate mergers and acquisitions, starting with problem banks, and going on to all banks. This recommendation was justly blasted by Chairman [of the Senate Banking Committee] William Proxmire as being anticompetitive, since mergers and acquisitions eliminate ongoing competitive entities. They do not create new ones.

Then in late 1982 the Garn and St. Germain Act, implementing the first part of these recommendations, made provision for the out-of-state takeover of failing thrifts and failed banks by bank holding companies, if certain stringent criteria were met.

Since that time, Congress has been silent on geographic deregulation. I point this out because it underlines the fact that the shifting sands of policy move slowly in Washington, and I predict that Congress will continue to move slowly in this area, which remains highly controversial.

Early in 1981 when the new Administration came into office, one of the key planks of its program was to lift the regulatory burden from the backs of American business, including American banking. We thought this pledge would result in less paperwork. We frankly did not think it would result in an ideologically motivated drive, using government lawyers to circumvent existing laws that stood in the way of how they thought the brave new financial world should be organized. We thought that, since a conservative government had been elected, conservative doctrine, tending to preserve established traditions and institutions, would be followed. In the financial area this has not been the case.

While the Comptroller of the Currency has been publicly criticized for his lax regulatory practices (most recently in the Bank of Boston laundered money mess), he has been very aggressive in seeking to undermine existing laws that stand in the way of his ideological vision of what the future structure of banking and financial services should be in this coun-

try. The chartering of nonbank banks, for both financial and nonfinancial firms, began with his administration. Those in the Office of the Comptroller knew they were exploiting a loophole in the law, looking toward undermining the national laws that determine banking structure in this country. They had to be aware that it was clearly contrary to the intent of the Congress. And if last year's Congress agreed on one thing, it was that the nonbank banks loophole should be closed. It was not a partisan issue.

The Comptroller proceeded to exploit this loophole, despite letters such as that of House Republican leader Bob Michel, who wrote on October 17, 1984:

> I would urge that you reconsider this decision and act instead to extend the moratorium through the early part of next year. That will give Congress an opportunity to act on comprehensive banking legislation which came close to enactment this year. As you know, both the Senate and the House Banking Committees approved legislation which would have closed the nonbank bank loophole: this reflects a widespread consensus in the Congress that this loophole ought to be closed. And I firmly believe that an extension of the moratorium would not be criticized, but instead would be widely applauded by members of the Congress.

In recent testimony before the Subcommittee on Investigations, Committee on Government Affairs in the U.S. Senate on March 12, 1985, the Comptroller stated:

> The statutory mandate of this office is to ensure that national banks operate in conformance with safe and sound banking practices and in compliance with the many and varied statutes affecting bank conduct.

But how does the chartering of deposit-taking nonbank banks for a furniture chain operating in California, which obviously has the potential of competing with national banks, meet this statutory mandate? How does helping national banks move through an obvious loophole in the law encourage the proper attitude toward other statutes that the Comptroller is enjoined to enforce?

Fortunately ours remains a government of law, and given the inaction of Congress, all financial trade associations have been driven to the courts at great expense to keep the excesses of financial regulators in check. As is well-known, all government excesses have been defined since time immemorial as being in the public interest.

My association sued the Comptroller, questioning the legality of his chartering of nonbank banks. Howard Meldon, a U.S. District Court Judge from Florida, granted our request for a preliminary injunction, saying in part:

> It is the Comptroller, not the Plaintiffs, who should seek Congressional authority before imposing his personal policy preferences relating to interstate banking on the banking structure of the United States. The public interest is also served by maintaining the integrity of the system of regulation that was established by Congress when it enacted The National Banking Act and Bank Holding Company Act. The Comptroller does not serve the public interest by issuing charters to nonbank banks when their only conceivable purpose is to enable their parent company to escape regulation under The Bank Holding Company Act.

Because of this court decision, the Federal Reserve has decided to suspend applications during the time the court injunction is in effect. The court action, unless reversed or limited, eliminates the ability of bank holding companies to open nationally chartered nonbank banks. At the very least, this decision should buy time for Congress to act, if it cares about the future structure of the nation's banking system.

Again, the fundamental question would appear to be: Is it the business of bank regulatory agencies to press to and beyond the frontiers of legal action to further their predetermined ideological goals? And what are the consequences to our system of government if the answer is yes?

Again, we ask the White House to order the Comptroller of the Currency to do his work and to get his heavy, ideological, and apparently illegal hands off the backs of the independent bankers.

Now a comment on the doctrine of forgiveness. Although a topic clearly more appropriate for a priest than for a trade association head, the practice of forgiveness has been imposed on all rural banks by this Administration. As of last August, to qualify for a loan guarantee by the Farmer's Home Administration, my banks are required to forgive at least 10 percent of the principal of the loan. Not surprisingly, this program was not working (for bankers are not priests), so a few weeks ago it was liberalized. Now to secure a Farmer's Home Guarantee, the banks can forgive principal and/or interest.

It has been argued that the price of securing such a guarantee is that rural banks have to give up (that is, forgive) something. However, when the rural banker turns his attention to guarantees attached to signed agreements between the International Monetary Fund and foreign governments, which ensure the payment of interest and principal on outstanding foreign commercial banks loans (and these IMF programs, as is known, are run at considerable expense to the U.S. government), he notices that there is no official forgiveness doctrine to be found in these foreign agreements.

And if a Latin American government head were to demand that the

forgiveness doctrine be applied to a U.S. Money Center Bank working hand in glove with the IMF to negotiate a loan restructuring package, he, no doubt, would be denounced as a radical. How dare anybody insist that similar conditions to those imposed on U.S. rural banks be imposed on these loans? It would be anti-American.

The IBA, my trade association of about 8,000 small community banks, is not naive, and so should be spared the big bank rhetoric about letting the free market work. If the free market had been allowed to work, a mega banking crisis originating from the LDC (less developed country) debt problems would have hit the U.S. years back.

The point is: the money center push for nationwide banking comes against the backdrop of very different rules of the game being applied to the various categories of banks in this country.

A final point. One of my fellow panelists is blessed; he represents a money center bank. His bank will not be allowed to fail by official government decree. His depositors and/or creditors are not at risk. How comforting it must be to help run such an institution, knowing that if all else fails, the U.S. government will move in and bail you out. And then, after having bailed you out at the cost of billions coming from the Fed and the FDIC, additional money from the discount window of the Federal Reserve system will be made available to you at less than market rates until you are out from under whatever it was that threatened to bring you under. You get your money at 9 percent at the Fed and you sell at 18, if you are making consumer loans. It is no wonder they have shown a profit in the last quarter.

It is precisely these fail-proof few who want full interstate deposit-taking now. And if they get it they can, and no doubt will, enter every attractive deposit-rich market in the country and pass the message "Your deposits over $100,000 are safe with us. We are the fail-proof few. But put your deposits over $100,000 in any other financial institution, bank or S & L, and you are taking a chance."

It simply is not fair, and it has very little to do with letting the free market work. The free market, which includes the right to fail, applies now only to small financial institutions and they have been failing in record numbers since the Great Depression. In this context, full nation-wide interstate banking would give an insuperable advantage to a handful of very large banks.

Dr. Feulner: Our second participant, Catherine England, comes from our neighboring think thank on the other side of the Hill—the Cato Institute—where she is a senior policy analyst and the assistant editor of *The*

Cato Journal. She is finishing her Ph.D. at Texas A&M, and she has written widely for Cato and for Heritage on various aspects of banking regulation, deregulation, privatizing, and other aspects of banking reform. Catherine, it is a pleasure to welcome you.

Catherine England: While in Philadelphia last summer, I visited a print shop that operates much as print shops functioned during the days Ben Franklin was in business. This particular shop is preserved as a historical curiosity, employing just a few people and selling the pamphlets and leaflets it produces to tourists.

I am telling you about the print shop because I would argue that, if the goal today is to send community banks and savings and loans the way of Franklin's print shop so that a century from now schoolchildren may view an operating community bank as an historical curiosity, there is no better way to accomplish that policy that to continue to protect these institutions artificially through outmoded regulatory restrictions, including limitations on interstate banking.

Recent rapid advances in technology facilitate an image of the day, in our lifetimes, when a consumer may choose a bank to hold and maintain his transactions accounts that has no physical presence in the city where that consumer lives. With bank customers already spending less and less time in bank lobbies, it is certainly possible to foresee direct deposits of paychecks, dividends, and Social Security payments, for example. Necessary transfers of funds or direct payments could conceivably be managed through home computers and debit cards. Nationwide automatic teller machine networks already provide ready access to cash, and banks currently provide credit cards and some lending arrangements through the mail to individuals across state lines. Attempts to forestall legislatively this easily predictable view of the future will surely be in vain, as the market is certain to find ways to work around whatever restrictions are attempted.

My purpose in suggesting such a scenario is not to sound a death knell for local banking institutions. It is rather to make the point that ultimately it is impossible to protect any group or institution as the market marches relentlessly onward. Small farmers are learning that lesson now, and community bankers likewise will be forced to accept the changing competition in other aspects of their business, for instance, as the advent of money market mutual funds introduced nationwide competition for time and savings deposits.

The best way to prepare local banks for a future of change is to introduce competition today. And one of the best ways to introduce

competition is through more liberal branching laws. There are five basic reasons why more competition is the ultimate salvation of the community banks as an institution.

First, there is little competition in many banking markets today. "Banker's hours" is a cliché too widely accepted and understood not to have some truth in it. Any businessman who is worried about his competition does not keep banker's hours. But then, I grew up in one of those rural towns where the two local banks were passed from father to son, so perhaps I have fewer romantic illusions about smalltown bankers.

Second, there is virtually no evidence that small banking organizations cannot compete effectively head-to-head with larger banks. They do so in upstate New York, throughout California, and in 23 other states that allow statewide branching. There are no economic cost studies that show significant economies of scale for banking. Recent reviews of the economic literature by both Charles Morris (in the November 1984 *Economic Review* from the Federal Reserve Bank of Kansas City) and Robert Eisenbeis (in the March 1985 *Economic Review* published with excellent bibliography by the Atlanta Federal Reserve Bank) report these findings.

In fact, many studies indicate that smaller institutions consistently outperform their larger brethren. As a group, smaller depository institutions have higher returns on equity, higher returns on assets, and higher net interest margins.

Third, the attempts by New York banks to move into upstate communities provide but one recent example where local banks were able to perform very well against larger competitors. These local bankers showed formidable strengths in their ability to serve their communities when they were encouraged to do so. The interest that they paid on deposits rose, the interest they charged for loans fell, and the perks that the local bankers were able to take for themselves were reduced. But profit margins in many cases were not significantly affected, once these local bankers began to compete.

Fourth, competitive adjustments are not made overnight. Suppose John Thompson's Hoyas were automatically invited to the NCAA as defending basketball champions. What if Coach Thompson were to forgo any regular season competition? He could ensure that his team was well rested for the upcoming tournament; he could significantly reduce the chances that there would be injuries to his key players. There are many potential advantages to such a decision, but I doubt that his chances of repeating the national championship would be very good if he pursued this policy, because in sports it takes competition to get ready for competition.

The thrust of this argument applies to business as well. Every year that

the U.S. continues to protect local bankers from competition takes away yet another year of experience in maintaining flexibility and anticipating and meeting depositors' needs. These bankers are allowed to grow a little more comfortable within what is ultimately an unrealistic situation, while their entrepreneurial spirit deteriorates yet a little further.

Fifth, ultimately regional compacts (though an improvement over the current situation) are as arbitrarily limiting as more narrowly defined branching laws, and they certainly should not be defended by small local banks. Coming from a rural town in Tennessee, I can tell you that, as much trouble as my grandmother would have putting her money in a Nashville institution as opposed to the local bank, she would have much less trouble with a banker from Nashville or Atlanta than she would with one from New York. Furthermore, for small bankers expecting to be bought out or merged, widening the system to full interstate banking creates more competition for their institutions and enhances the potential gains for local stockholders and bank owners.

Competition brought about by interstate banking undoubtedly would cause some institutions to fail, to be bought or merged. But those that remained would be stronger for their competitive battles and would stand a much better chance of surviving into the 21st century as viable institutions rather than as historical curiosities.

Dr. Feulner: Bill Dabaghi, our third speaker, is a long-time participant in the Washington scene. He is a partner in the Washington office of Arter and Hadden, a member of the Washington and Texas bars, and a specialist in financial institutions and law.

William K. Dabaghi: This morning I discovered that the origins of all the controversy among bankers today may actually be traced to the Chase Manhattan Bank because, as I understand it, Chase Manhattan began as the Manhattan Company. On its board of directors were Aaron Burr and Alexander Hamilton. Obviously those two did not get along. This discussion today is therefore a shootout in the old tradition.

The Heritage Foundation hit on a particularly key issue. After all, pending before the Congress and the regulatory agencies are not only the key issues of the budget, taxes, and national security, but the structure and adequacy of our financial system. And no issue has been more controversial or debated longer than interstate banking.

First, I fully support Ken Guenther's concerns regarding the nonbank bank issue. The present geographical structure allows for a significant diversity of activities. For instance in the international banking area, Edge

Act subsidiaries of bank holding companies are allowed nation wide as long as they have been approved by the Federal Reserve Board. Loan production offices, the ability to make commercial loans nation wide, is also allowable. So there are certain activities of banks that are not restricted by geographical boundaries and do serve the American consumer under present banking law.

On the other hand, banks are geographically restricted in taking deposits. The system has evolved over the past two hundred years with checks and balances concerning the concentration of wealth and political power and the promotion of local ownership of financial institutions and of community involvement and control. Congress—in enacting the McFadden Act of 1927 and the Douglas Amendment to the Bank Holding Company Act in 1956—has delegated to the individual states the right to decide questions regarding intrastate and interstate banking issues. Therefore, I would like to underline the positive and progressive nature of the states' rights, dual banking system that has in fact served this country quite well for a long time.

The system faces two very specific challenges by the New York money center banks and their strong and effective lobby. The first challenge is in the courts. In connection with the regional banking movement, for instance, it is taking advantage of the express authority in the Douglas Amendment to the Bank Holding Company Act for a state to decide, if it chooses, to pass a statute allowing bank holding companies from other states to reside within its borders, if there is reciprocity. The State of Maine began this process in 1975. Leaders were looking for opportunities to invite banking interests and capital into the state, and clearly the language in the Douglas Amendment allowed it. They eventually decided to enact a nationwide nonreciprocal statute. Anyone who so desired could enter the banking world in Maine.

In 1982, legislators in Massachusetts took a different tack. They felt that there was something unique about the New England states—the economy, the history, the businesses—so they passed a law in 1982 that allowed for reciprocity within the New England states. Soon Connecticut and Rhode Island followed and now there is, in fact, regional banking in New England. Obviously, the people of these states thought this was in their best interest. There are now a few pending mergers based on these reciprocal statutes, there are twelve states with regional statutes, and the number is growing. Many more states are considering such statutes, and I predict a substantial number will pass in various state legislatures this year.

The Federal Reserve Board studied these mergers based on the state

statutes and decided they were appropriate and constitutional and approved them. Northeast Bancorp of Connecticut (which would like to merge with a New York bank) and Citicorp sued, and the issue was taken to the Second Circuit Court of Appeals, which upheld the constitutionality of these statutes. Currently, this case is pending before the U.S. Supreme Court. Chase Manhattan Bank just filed an *amicus curiae* brief with the Supreme Court on this issue. The Solicitor General of the United States believes these statutes constitutional and advised the Supreme Court not to take up the case. The Court decided to hear the case nonetheless.

The states have acted, and on the basis of the statutes, bank mergers have been planned to serve consumers in the regions, but progress has been blocked by the ongoing court case. The issue was joined in Congress by the Coalition for Regional Banking and Economic Development to reaffirm Congress's delegation of authority to the states in the Douglas Amendment.

In the 98th Congress, the U.S. Senate passed legislation that included reaffirmation of the Douglas Amendment authority for each state to enact regional statutes, if it so chose. Senator D'Amato (R-NY) filibustered this provision but lost in one vote, 95 to 2. So when Congress has the chance to vote on the issue it invariably decides that the structure formed by the McFadden Act and Douglas Amendment makes eminent sense.

There is a related issue before Congress: whether or not to change the banking system by enacting a nationwide interstate "trigger." I am opposed to the "trigger" because the system is working and, with regional statutes, is progressive. The states are answering the questions regarding the availability of banking services and are fulfilling the needs of the consumers. The Comptroller of the Currency, the FDIC, and the Federal Reserve Board agree with this position. The National Governors Association, the Southern Governors Association, and local officials groups fully support this effort.

There are those who are worried that there are too many small community banks and regional banks, and clearly 14,000 banks is a very large number, but that is the way the system has evolved, and it is a political call. Rather than a few banks like Canada or Germany, the U.S. has many banks and serves the people. This multiplies the political and economic opportunities of the American people to prosper and have a say in their system.

Dr. Feulner: Our final panelist this morning comes from that much maligned sector—the big banks. Ed Shaw is a veteran of both the Washing-

ton and New York scene and a former partner in the New York firm of Milbank, Tweed, Hadley and McCloy. He worked at one time on the Senate staff of Senator Robert Kennedy. He is now Senior Vice President and Chief Legal Officer for Chase Manhattan Corporation.

L. Edward Shaw, Jr.: The debate on interstate banking today focuses to a large extent on two fairly recent phenomena—nonbank banks and regional compacts. We could spend a lot of time arguing the nature of the so-called loophole, and why Congress considered a different form of amendment to the Bank Holding Company Act fifteen years ago, which would have closed the loophole, but did not pass the amendment. We could also argue about whether Congress has had sufficient time through three or four different moratoria to consider the issue, and whether regional compacts are unconstitutional.

However, I would like to spend my time on what we think is the primary goal of banking, and whether it would be affected by interstate banking in some way that might benefit the consumer. Looking at some of the evidence that seems to be emerging on this subject, I would also like to address the issue of concentration: would interstate banking result in economic or political concentration?

We at Chase think that the real point of the debate should be how well banks can serve the needs of consumers and the U.S. economy. Fifty years ago, in order that small unit banks could come forward and serve the emerging needs of industry and commerce, there was a change in the National Bank Act, a pro-intrastate geographic expansion bill which permitted national banks to open branches throughout the states in which they were headquartered so long as local law permitted it. As Representative McFadden said on passage of the legislation bearing his name: "As a result of this Act, the National Bank Act has been so amended that national banks are able to meet the needs of modern industry and commerce."

Fifty years later the structure is basically the same as far as branches are concerned. The question becomes: Should not the goal of the banking system be to allow banks to meet the needs of the consumer, industry, and commerce as those needs exist in 1985?

A number of the recent stories in the press make it all too clear how easy it is to lose sight of the goal of promoting benefits for consumers and the economy. Press coverage of the Citicorp/Maryland agreement showed that the primary goal of banking for many is the promotion of regional compacts and/or the protection of Maryland banks. For example, *Washington Post* stories speak volumes when reporting that this deal

"which would create an estimated 1,000 jobs in a depressed area of Maryland has drawn strong opposition from Maryland's banking industry." The *Baltimore Sun* reported that the Chairman of the Senate Banking Committee agrees that 1,000 jobs are important to the economy but "warns legislators not to lose track of the much broader issue—Maryland's role in regional, national interstate banking—and the impact of the Citicorp decision on the Maryland banking community." The question should be raised whether these factors should be the important issues for the public policy debate or should the benefits of competition for the public be the main issue?

Another example of this topsy-turvy approach recently occurred in New Hampshire where an interstate banking bill was defeated despite the support of a long list of such groups as the Business and Industry Association, the State Realtors Association, and the Association of Commerce and Industry. It failed because of the opposition of the New Hampshire Community Bank Association, which argued that out-of-state bank entry would result in less responsiveness to customer needs. We think they were wrong, but for the time being their action has denied Chase and others the opportunity to prove in the market that they were wrong. But while the New Hampshire marketplace remains closed, experience elsewhere supports our case.

A recent study published by Federal Reserve economists sums up the situation in this way:

> The evidence suggests that interstate banking would result in a more competitive banking system . . . [and] to the extent that interstate banking leads to entry into small banking markets with only a few banks, the markets would become more competitive.

It would seem reasonably clear that competition is great in theory. Why, then, do opponents of interstate banking believe it would be counterproductive in practice?

First, there appears to be an assumption that competition would prove too much for local banks. Second, there is a suggestion that interstate banking would cause greater concentration, which might eventually lead to anticompetitive behavior.

As regards the first, competition is not necessarily bad for local banks. All the evidence on this says so. I have seen none to suggest otherwise. To return to the experience of a number of banks in the upstate New York banking market in the 1970s when that was opened up, Chase, like other large banks, found that competing up there was not an easy task. In fact, to be blunt, we took a licking from a number of our smaller correspondents.

A 1981 study by Federal Reserve economists indicated that "small banks can grow rapidly in an environment that includes large banking organizations, and that new entry by large organizations does not adversely affect their growth rates." Another study indicated that "for 43 small, independent banks, the entry, by merger, of a larger outside organization did not have any significant effects on profits." This study concluded, "The existing evidence, then, indicates that small banking organizations remained profitable when faced with competition from large organizations." The experience in California and Oregon also supports this thesis as it illustrates the viability of small banks in liberal branching states.

Thus, the available evidence, as viewed by unbiased professionals, suggests that protectionism for smaller banks through preventing competition is absolutely unnecessary—no one really needs it. Such protectionism not only would stifle competition; it would negate the goal that must be kept in mind. That goal is increased competition to benefit the consuming public. That there is a link between more competition and consumer benefits can be proved through the evidence from a number of recent studies on the subject.

According to a 1984 survey by Federal Reserve economists: "A number of studies found that entry substantially improved unit bank performance in a number of 'one-bank' towns before and after entry by an outside bank." Another study looked at the performance of banks in markets previously served by one, two, or three banks. They found "the net benefits of entry substantial in number and magnitude. Before entry the sample banks . . . paid lower interest rates on time and savings accounts and had a greater proportion of expenses due to officer and employee expense. In the year after entry, the banks in the entry markets raised the interest rate paid on deposits." This study also found that with entry in branching states "over a five-year period after entry, service charges on demand deposits fell in the entry markets in all five years."

In sum, lower fees on transaction accounts and higher rates on deposits are the real consumer benefits brought about by increased competition. Thus, we think that the competitive benefits to the public are clear and that this is due in part to the competitive vigor shown by smaller banks following entry by larger banking organizations.

This raises the question of whether interstate banking would have a downside risk of concentration and anticompetitive behavior in the long run.

Two of the clichés about the U.S. banking industry are that: 1) it is enormously fragmented, with some 14,000 banks, and 2) that there is

great potential concentration if interstate banking is allowed.

The empirical findings suggest that bank holding company expansion does not generally cause greater concentration. Charles Morris, an economist with the Kansas City Federal Reserve, finds: "The evidence indicates that interstate banking is not likely to result in more concentrated banking markets." A 1970 study done by the Federal Reserve indicated that the banking holding company expansion "did not significantly increase local market concentration." Another study showed that such expansion had no effect on concentration or on the market share of acquired banks. A more recent Federal Reserve study has shown that "When bank holding companies open new banks in rural and small metropolitan area markets, significant decreases in concentration follow."

It is no wonder that the antitrust division at the Justice Department has come out strongly in favor of interstate banking and against restrictions of the type that the Fed had proposed to discourage the use of nonbank banks by bank holding companies.

The March 1985 *Federal Reserve Bank of Atlanta Economic Review* contains very interesting data on the basis of which an increase in concentration is projected at the national level if interstate banking is permitted. Although Chase has not had an opportunity to assess this data in detail, it is fair to say that the article does not foresee any adverse economic effects as a result of increased concentration. We hope this study will stimulate serious discussion of the issue that penetrates beyond the clichés about greater concentration.

Another approach to the overall concentration issue is the consideration of how unconcentrated the banking industry is today, especially relative to other parts of the financial services industry. As one writer has put it: "It is readily apparent . . . just how small the very biggest banks are in the overall scheme of domestic banking. The largest bank in the country—Citicorp—has a domestic deposit share of less than 2 percent. If it had the capability of acquiring Bank of America, First Chicago, and the biggest bank in Texas, its share would still be less than 5 percent." In fact, if the three largest banks in the country merged, their combined share would be just 4.9 percent. The total share of domestic deposits at the ten biggest banks in the country is just over 10 percent.

In any perspective, these statistics illustrate how unconcentrated the banking industry is. If they are compared with the securities industry or with the insurance industry, there is even more evidence that banking is extremely unconcentrated.

Given an industry that is so unconcentrated, it is difficult to imagine any new developments that could lead to undue concentration. One ob-

server has estimated that interstate banking and deregulation together could potentially reduce the number of commercial banks by 30 to 50 percent over the next decade. But even if this were to occur, it would not mean that particular markets would become concentrated or the reduction in numbers would be caused by the unlimited growth of the largest banks. There are a variety of reasons why it is doubtful that the largest banks would be more successful than other banks in increasing their relative size. All banks, but certainly the largest, would be limited by the Federal Reserve in its administration of the anticompetitive standards in the Bank Holding Company Act. These banks would also be limited by their capital positions. As one writer has put it: "Since doubling or tripling in size takes years and . . . lots of money, there is little chance of any banking organization reaching a 5 percent share of the market in fifteen years—and with anything less they could hardly expect to be much of a competitive factor other than in a handful of geographic markets."

In sum, a review of the available evidence and reasonably possible developments shows that there is no legitimate basis to oppose interstate banking by reason of concerns over undue concentration either in local banking markets or nationwide.

To return to the original questions: What is the goal of the banking business? What is the rationale for proposing changes in the banking system? We believe the goal should be to enhance the ability of the system to serve the economy and the American consumer rather than to protect the turf of any actor or actors in that system.

It is evident that full interstate banking would benefit consumers and that its alleged pitfalls are more imaginary than real. Consumer benefits are really the only criterion that should be used. Therefore, the question is simply whether to deliver those benefits now or to allow parochial interests to continue to force the system into convolutions like nonbank banks and divisive anachronisms like regional compacts.

Chase hopes that the real issues will be joined and that the debate in Congress and across the country will focus on the consumer benefits perceived as a result of increased geographical competition rather than shibboleths like undue concentration.

Dr. Feulner: Each of our four participants will now have several minutes to reply. And if there is nothing they want to take exception to from the other panelists, here is a question for each: What is going to happen this year? What is going to happen over on the Hill? Ken Guenther.

Mr. Guenther: First, a word of caution and wisdom from one of the great

conservative fathers of our time, Arthur Burns, who said, "The essence of conservatism is before you replace a law or regulation, be damn sure that what you replace it with is better."

I would like to comment on Catherine England's words. I was a little surprised at the simplistic nature of her presentation. A discussion of full interstate banking has to include the differences between implementing interstate banking by doing away with the Douglas Amendment or by doing away with the McFadden Act. I do not think there is any academic expert who does not share the intellectual premise that if the Douglas Amendment is rescinded—that is, bank holding companies are allowed to go across state lines and pick up existing banks in other states—there will be fewer competitive units and fewer banks, and this is going to have an adverse effect on competition.

It is more difficult to make that argument about McFadden, but in the absence of the Douglas Act, one of the first acquisition targets would be the major regional banks in the Sun Belt areas of the United States. Banks like Texas Commerce would go on the block, as would some of the more attractive Atlantic banks. The money center banks would bid with a vengeance for banks like Texas Commerce. But there is a great difference in size between a Citicorp and a Texas Commerce. Even if Texas Commerce took over every bank holding company in Texas, it would still be a relatively small regional institution. If without Douglas, the main targets are going to be these healthy, viable, major regional banks, and if Citicorp or Chase or Bank of America picks up Texas Commerce, competition will be very, very ill-served in this country.

This is the way in which interstate banking is evolving. There will be more pressure to change Douglas, not change McFadden. This is not in the interests of competition, and as I stated in my introductory remarks, this was the essence of Senator Proxmire's reaction to the Carter geographic deregulation support.

My second point concerns the rhetoric that the market marches on and that the small banks are out there being protected from competition. I would argue that, if there is protectionism in place now, it is protectionism for the larger banks. I refer, by way of example, to across-the-board intervention to make sure the problem of the less developed country (LDC) debt does not explode. This is protectionism by the government. In addition, the greatest protection that a government can give to any financial institution is that it will not fail regardless of what happens. This is the government guarantee to the money center banks.

The fact of the matter is that many large money center banks are not fully capable of running all aspects of their businesses, and the govern-

ment is moving in. Paul Volcker will probably spend more time on the LDC debt issue than on any other. So I do not like to hear the refrain that the small banks are benefitting from government protectionism and that the free market money center banks do not have the help of the U.S. government protectionist network. That mythology does not wash anymore, after the Continental Illinois story.

Now I support this protectionism: I support the IMF legislation, but it is protectionism. Protectionism is in place, yet it is not in place for the independent bankers, who are going down in the greatest numbers since the Great Depression. And 1985 is going to be a worse year than 1984.

What is going to happen this year? It is going to be tough, because the forces and the issues are more focused and people are attacking these issues in sharper ways. The conflicts within the banking industry obviously are sharp. And then there is the other aspect of deregulation, product deregulation, which involves the sanctioned turf of the insurance agents, who are very powerful, or the American Council of Life Insurance, the real estate people, Securities Industry Association, the Investment Company Institute. So deregulation, product or geographic, presents problems.

I would hope that this year will see a fairly modest package emerging from the Congress along the lines of last year's Garn bill. For that, Chairman Fernand St. Germain (D-RI) of the House Banking Committee has to make some major concessions on the power side, recognizing that the Republicans won the election and have control of most of the levers of this government. But I think that, if attempts are made to go much further beyond Senator Jake Garn's (R-UT) bill passed last year by an 89 to 5 vote in the Senate (which is a good bipartisan vote), it will simply stir up many more adversely affected interest groups and could end up with no legislation.

Now there are two action triggers out there in 1985. By October 1985 the Congress must act to keep in place Title I of the Garn bill, which is the title providing for the takeover of failed banks and the takeover of failing thrifts. This is an essential title because it is a safety valve allowing the Federal Home Loan Bank Board to dispose of failing thrifts at a minimal cost to the FDIC. The second trigger refers to the expiration in October 1985 of the Net Worth Guarantee Program, the program for capital infusion into the thrift industry, which we are trying to extend to include small agricultural banks. The expiration in October 1985 of both these key pieces of legislation will probably act as a springboard for some sort of broader banking legislation this year.

Dr. Feulner: Catherine England.

Miss England: Well, I am sorry Mr. Guenther thinks I was simplistic in my presentation, but let me throw the ball back in his court and say that I think it is simplistic of him to say that reducing the number of banks in this country is anticompetitive. Good antitrust analysis requires correct definition of the market. And for many banks—for many banking customers—markets are very narrowly defined.

In fact, I would argue that comparing the number of banks in a single city within a unit banking state with the number of banks in a similarly sized city of a statewide branching state is misleading. For, in a unit banking state, a market analysis that looks at an entire city defines the market too broadly. People do not drive across town to do their banking. They want convenient services. Of course, this may change if the nearby bank fails to offer the better services, for I am confident that bankers in other areas would find ways to meet the needs of poorly served customers, even if those customers were fairly isolated. But in talking about concentration in banking, only very narrowly defined markets can be looked at, at least for now. Small banks face potential danger, however, in that technological change may allow markets to broaden much more quickly than many local banks expect them to.

I would like to make a second point. I have not seen any study that suggests the number of banks in the U.S. will approach the handful of Canadian banks. All studies conducted by independent groups considering the future of a totally deregulated banking system suggest that thousands of financial institutions will remain in this country. We are a nation that appreciates and promotes diversity, and the larger banks, with all their size, still have not found a way to take people's money. They must convince potential customers to give them deposits, and people will give large banks deposits only when they are offered better service or higher interest rates.

I agree in many respects with Mr. Guenther's analysis of the Continental decision. In fact, I wrote a *Backgrounder* for The Heritage Foundation discussing significant drawbacks to the Continental decision, including how it gave a competitive advantage to larger banks in certain situations. But that issue is quite separate from the interstate banking issue.

In my original statement I wanted to make the point that there was no diversity between banks in small towns. Where I grew up, a person chose a bank because that was where his father banked, not because it offered better services. In fact, all the banks offered the same services. One of my professors in graduate school told the story of his efforts as a consultant to

help open a new bank in a small town in Texas, which is a unit banking state. In a hearing before the state banking commissioners, one of the town's existing bankers was asked: "Given competitive strains under which you say you operate, what do you plan to do about rapidly rising interest rates?" The banker replied, "Well, actually my competitors and I were discussing that just the other day. . . ." There was a dead silence in the room. The cat was out of the bag. I believe that this may be the case in many situations.

Finally, many of the failures among small banks today are directly attributable to past regulatory restrictions. Bankers were suddenly thrust into a competitive environment by the high interest rates of the late 1970s and early 1980s, having no idea of what it cost them to offer specific services, no idea of how to price their services to bid for deposits, unable to diversify their loan portfolios or to broaden their deposit bases because of regulatory restrictions. These are the sorts of things that lead to weaknesses in the system. I would argue that Citibank, for instance, has been able to expand its interstate operations more than it could have under a more competitive, more open system, because Citibank has managed to hire creative, innovative people who sit in New York and find loopholes through which to expand services in other states. Citibank has the money and the resources to search for loopholes and to lobby the Federal Reserve to accept those changes. On the other hand, smaller banks that might have been able to take advantage of opportunities to expand geographically, had they been freely available, could not because they could not hire the people to find the loopholes and the ways to offer services.

Dr. Feulner: Bill Dabaghi.

Mr. Dabaghi: My prediction for the Hill is based primarily on what we saw last year. I thought Chairman Jake Garn of the Senate Banking Committee did an outstanding job guiding a significant banking bill through the Senate during an election year, at a time when everyone said it could not be done. He did it with 89 votes out of 100 at the final rollcall. That kind of determination and perserverance produces a banking bill, and I am certain this bill is going to have a nonbank bank loophole closing provision and a reaffirmation of the states' rights to expand into regional banking if they choose.

In the House, Chairman Fernand St. Germain is very serious this year in his determination to pass legislation. So I predict we are going to have legislation and that it may, in fact, not be too far away.

First of all, Catherine England really made my point. I am here to talk

about money and resources, the ability to spot the loopholes in present law and to go to each state and enter into the political process, which is what happened in Maryland. Here was a situation where a blue ribbon committee was appointed by the governor to see what was in the best interests of the State of Maryland and its citizens. And I assume that there were people from various walks of life and professions and not just Maryland bankers on the panel. And the panel said that it is in the best interests of the State of Maryland and its citizens to pass a regional statute with a "trigger" in four years. That is fine. But Citicorp, discovering a rundown plant in an area of Maryland that was not economically booming, approached the Governor behind the scenes and offered to buy the plant, saying, "We will also provide you with a thousand jobs." I have added up the jobs that have been promised all over this country in Nevada, in Texas, in Florida, in Georgia, and they approximate many thousands. I am beginning to wonder who is going to go out of business to create these jobs in the different states. The Governor acquiesced, not on the basis of financial services for the citizens of the State of Maryland, but to take off of his hands this plant he evidently acquired free of charge from the Fairchild Corporation.

I wonder about the politics of this situation. And I wonder about the political attitude that accepts that sort of deal when the problem regarding the structure and viability of the banking system is very serious.

Ed Shaw said that a 5 percent domestic deposit share of all the deposits in the United States, even if acquired in ten years, does not matter, that this is not enough. But just think of the power exercised today with only 2 percent of all the deposits in the United States, and then think of what could be done with 5 percent of all the deposits.

Clearly, this is a political question, one that the people must decide. Over the last 200 years, people have said, "Yes, Citicorp can grow to $150 billion in size, but not to $1 trillion." In the U.S. system the states and the people in those states have a part, and they are not going to accept any circumvention of the system in Washington that will serve as a national "trigger" allowing overnight change in the financial system. I read Catherine's study on the privatization of the FDIC (and she entered the debate on a very intellectual and high plane regarding the future of the FDIC), and even there she said that, if privatization occurs, it should be a very gradual process. I am concerned about the changing of the financial system overnight and whether it is in the best interest of the American people.

Dr. Feulner: Ed Shaw.

Mr. Shaw: I would like to second Catherine's comment. And I agree that LDCs and Continental Illinois are not entirely germane to the question at hand. Nonetheless, I shall try to set the record straight on each of these issues and then move on to the others.

Number one, the implication has been made that bank loans to LDCs have somehow been guaranteed by the United States government. I guess I have really missed what I should be doing in my job, for I am unaware of any such guarantee. Many banks, including ours, have been significantly hurt in their earnings statements during the last several years because we have not been able to receive payments of interest from the LDCs, and it is a major problem. Nobody, as far as I know, has proposed that we take a 10 percent write-down on those loans and thereby receive full government guarantees. Maybe that is not what was suggested, but I think it is, and I am not aware of it.

Second, there are a number of things that can be said about Continental. First, I tend to agree with those who would say that in many respects it did fail. The management of Continental was not protected: they are all gone. The shareholders are substantially wiped out. What was saved was, in effect, some of the depositors and some of creditors. And a lot of the pressure to save those creditors was brought by members of the IBA who had substantial amounts on deposit at Continental. I think it also fair to say the notion of "too large to fail" is an issue with initiative effects that must be addressed seriously, not only within the banking industry, but in its effects in areas of our society outside the banking and financial services industry, in nonfinancial services areas.

Finally, on Continental, it is important to note that not all big banks pay the same rates to raise money. To this day, many significant depositors continue to distinguish among the larger banks according to which they think are more credit worthy. Talking to exchange traders in London, where a lot of money is raised, would reveal that on a regular basis different banks do pay different rates. So clearly, there is no government guarantee of all deposits that prospective depositors are prepared to rely upon.

Turning to McFadden and Douglas for a moment, we at Chase would be delighted to see a change in either. Indeed, a change in McFadden would allow us to open branches across state lines rather than have to go through the somewhat more difficult process of having a holding company subsidiary. If McFadden were offered, we would be delighted to accept it on the spot.

As far as the Hill this year is concerned, I will simply make two comments. First, one of the significant problems with the legislation last

year was the attempt to ratify in general terms whatever kind of interstate compacts might come down the pike. I am glad to say that there were some people in the House who were seriously concerned about that issue, perceiving that it would effect a basic change to a constitutional provision that has served the country well for many, many years. I view that as a good sign for the country and for Chase. Second, I think that this constitutional issue will be with us once more this year, and its recurrence may well affect what happens in the legislature. Let us not forget that regional compacts are a very divisive issue. A look at the history of the kinds of regional compacts that Congress has approved in the past reveals there has never been anything that is close to the blank check that is being sought in the proposed blessing of the interstate banking compacts.

Finally, I return to the point that we ought to be trying to design a system. We ought not have people trying to close loopholes and trying to create loopholes. There are market forces out there; there is a consumer to be served, and we would like to have the marketplace open up so that we can compete in the markets and expend our energies on serving consumers rather than chasing loopholes. If the customers in Tennessee, in upstate New York, in California do not like what is offered, they will not use the services. It is as simple as that. Let us just give it a chance and let the consumers make the decision.

Dr. Feulner: Now for comments and questions from the floor.

Karen Shaw, Bank of America: The system of support that surrounds smaller banks includes small business loan guarantees, housing support programs, and agricultural subsidies. And, as Mr. Shaw said, the IMF provides support directly to countries but does not guarantee loans. This protectionist environment provided by the government extends far beyond the money center banks and cradles the smaller banks a lot more closely than Mr. Guenther has indicated.

Mr. Guenther: I mentioned that the forgiveness doctrine—a doctrine of the President of the United States—is applied only to the rural banks. It is not applied to the principal or interest when there is a major debt rescheduling going on with an LDC debt. It is a fact of life that, when a country signs an agreement with the IMF, part of that agreement (or the subsidiary agreement that is concluded with the banks at about the same time) is that the interest on the outstanding debt will be paid over X period of time on Y terms. This is a renegotiation of debt just as the banks in my Association renegotiate farm debts. The IMF guarantees the pay-

ment of that debt, maybe not according to the letter of law, but that in fact is precisely what happens. As the process goes forward, there is no forgiveness of the principal. On the other hand, the U.S. government is there saying to the rural banks, "You have to forgive." They are the only ones under the forgiveness doctrine. That is my only point.

Ed Hudgins, The Heritage Foundation: I would like to follow up on the last comment Mr. Shaw made. In New York State the branch system seems to indicate that the market works. In that situation, the biggest banks did not gobble up all the others in the state. Since banks are just like any other business, and they are in the business of lending money, why not turn it over to the tradition of free choice and let the citizens of the various communities decide what bank they want? If Chase Manhattan goes into the small Tennessee town and people do not trust Chase Manhattan, that is their choice. Why not let the people decide? Is that not basic American free enterprise that seems to work in this country?

Mr. Guenther: There is something very special in New York. When the deal was struck there between the various banking entities, home office protection was put in place. This means that the smaller communities under 5,000 received some sort of protection. In the states where this home office protection is not in place, where there is no across-the-board liberalization (the Carolinas are a very good example), the health and the vigor of the community banks is not so great as in a state like New York where a special legislative deal was struck. In addition, the number of community banks in New York is down substantially over the past ten years.

Mr. Shaw: In New York, home office protection existed in the 1970s but has been scaled way back. Even in the New York City area, where there was no home office protection, there are many small banks in Manhattan, Brooklyn, Queens, the Bronx, and Staten Island, which compete very well. So let us not get sidetracked by suggesting that the relatively small towns upstate that had home office protection survived only because of that head office protection. The same thing happened in other unit banking states: Small banks can compete very well.

Mr. Dabaghi: I agree with the questioner: The people should decide. How they should decide is the question. I believe the structuring of a financial services system is a political question that should be decided by the state legislatures and by Congress, not by spurious lawsuits.

Mr. Hudgins: But don't you think that kind of political decision takes away the force of the market? People might then say there should be a vote on which companies produce cars and how many may be produced in this country and so on. In other words, what you are saying is that there should be a political decision rather than a market decision.

Mr. Dabaghi: Not entirely. As we all know, it is a mixed situation having a central bank—the Federal Reserve Board—which regulates bank holding companies and federally insured deposits. And yet no one is arguing that the country should not have this kind of federal oversight and insurance during this period of time. For example, concerning the problems that are facing Ohio and the political questions that the situation there brings to bear, I grant you that the market is going to play a significant part in the resolution of these problems. But clearly in any financial system worldwide—bar none—there are overriding political questions as well, and the trick is how to balance the two forces to give the best, the most secure, the safest system to the customer. At this point, some of these questions should be decided by the state legislatures, and some by Congress; least able to decide these questions, in my view, are the courts.

Unidentified Guest: I want to ask a three-part question, two to Ed Shaw, then a general question on which I would like all of the panel to comment because it is a relevant new development that has not come up in the discussion yet.

As for the first two to Mr. Shaw: there has been some suggestion that the Supreme Court grants *certiorari* easily and that a mere clerk makes that decision at the Supreme Court; would you briefly summarize the major issue that is before the Court in terms of the Citibank case itself and the Chase *amicus curiae* brief, along with any others.

Second, the Lincoln First merger in upstate New York that Chase recently completed has received much attention in terms of its possible benefits. Could you comment on how it has reached consumers in the community and how the community itself has reacted to the merger as opposed to a branch system?

And then the third question which is addressed to all on the panel pertains to the recent speech by the Chairman of the Board of Sears at the Detroit Economic Board, in which he spoke of the so-called family bank proposal as an alternative to the so-called nonbank bank loophole. I ask the panel what they think of the merit of this proposal, which will be part of the congressional dialogue this year.

Mr. Shaw: To answer your first question, as far as the Supreme Court decision to grant *certiorari* in the regional compacts case, that is not a decision made by the clerks, because at least four members of the Court itself must decide whether an issue is sufficiently important or unclear in order for the Court to spend time and effort in an attempt to resolve it. The issue there is the basic constitutional issue, the regional compact issue, which raises the question as to whether or not the Douglas Amendment drafted in 1970 allows individual states to open their states to entry by other state bank holding companies on a discriminatory basis. Scrutiny of the Douglas Amendment indicates nothing in the statute to suggest that states are to be allowed to pass legislation that discriminates reciprocally and on a regional basis. It seems to us that it is clearly the type of regional compact that the constitutional fathers sought to outlaw many years ago because it pitted one region of the country against other regions of the country. As far as Chase Manhattan is concerned, the New York banks have basically been redlined. We cannot go into the New England area; we cannot go into the mid-Atlantic area. I can sit in my office and look two miles away to New Jersey where we have a great number of employees, and yet we cannot go across the Hudson River. I think that the regional compact issue has certainly stimulated the debate on interstate banking, but it has also touched some fairly raw nerves. Chase thinks it is an important issue, and I am glad to see that the Court thinks so too.

Turning now to your second question, our experience with Chase Lincoln First is instructive. References have been made to the idea of local ownership, but Chase thinks that local management is at least as important as local ownership. As a result, we kept Lincoln as a separate entity. We kept its management, indeed we kept the board of the directors which it has had for many years, composed of leading businesspeople in Rochester and elsewhere in upstate New York. They may not always do things just the way we might, but they are much closer to the market, and we think in the long run this is the best procedure. All in all, it has been a happy merger. We think of it as a prototype of the way to expand by acquisition and yet end up with a bank that is very responsive to community needs and capable of providing the additional services to meet those needs.

Mr. Dabaghi: First of all, no one knows at this time whether or not the Supreme Court will consider these state statutes to be compacts, so to call them compacts is a misnomer until the Supreme Court makes a final decision. In the meantime, the U.S. Second Circuit Court of Appeals, in considering this issue, did not address the question of whether these were

compacts or not, stating merely that they are constitutional because Congress has delegated authority.

In terms of discrimination, one could say, with McFadden, that we have inherited a system that is already divided into fifty states. What the regional statutes appear to do is broaden that system so as to make the current situation more progressive, more able to serve the communities at large. So I question the discriminatory notion. I do not think there is anything wrong with individual states determining if other state bank holding companies may operate within state lines, particularly within the system that we have inherited. It seems apparent that the issues can be viewed quite differently at this point.

Mr. Guenther: Sears wants to get into the banking business, there is no doubt about it. That they want to get into the banking business with full-fledged family banking raises a fundamental question that has been with us throughout the history of our country: Should there be in place, and within the law, a separation of banking and commerce? Our country is unique in terms of maintaining this separation. That is not the case in Japan; it is not the case in Germany nor is it the case in most European countries. And our system has done extraordinarily well. After all, it is the most successful economy in the world, a fact no one can dispute.

In opposition to Sears is Paul Volcker, who gave formal testimony before the Subcommittee of the House Energy and Commerce Committee saying, "I don't want Sears to get into the banking business." Now I think Paul Volcker has a good deal of credibility; anybody who has ever worked with the Federal Reserve knows one thing: the buck stops there. Whenever there is a major financial crisis, whenever financial institutions get into trouble, the first place they turn to is the Federal Reserve, the Fed discount window. And I do think that Paul Volcker's voice should be given more weight than the voice of Sears. Furthermore, the whole historical tradition of this country has been that a bank should not own a shoe store and a shoe store should not own a bank, which notion was defended in a major paper on what makes a bank unique by Jerry Corrigan, the former president of the Minneapolis Federal Reserve Bank.

Phil Corlan, Legislative Counsel for the Independent Bankers Association of America: Can the panelists who advocate reliance on market forces to protect society's interests imagine any point at which the government should step in to limit consolidation and concentration in the industry? Suppose deregulation led to a situation in which three or four banks managed to dominate the whole country. Would that justify government intervention?

Miss England: If the country ended up with only three banks because consumers had decided that those three banks alone served them best, I see no particular problem. However, I do not think that would happen. This again raises the issue of the nature of banking. I do not think the question of bank structure should be a political one. It has become a political question, however, as have many other business decisions. But it ought to be a market decision. I believe consumers can be trusted to protect their own rights and interests more effectively than Congress or state legislatures can be trusted to protect them. So if there is a possibility that the decisions of consumers could sharply reduce the number of U.S. banks, so be it.

Mr. Shaw: As far as the Continental issue is concerned, again I think that the holding company debt that had to be covered because special covenants they happened to have in their indentures did create an issue. And, to the extent to which Chase is in favor of the idea of separate subsidiaries as a means of exercising new powers that are closer related to banking, I have to agree that we think that holding company creditors or their subsidiaries certainly should not be brought within any kind of rescue. Of course, it is easier to say that now, eight months later, than when the crisis hit. In this context, I repeat that different banks among the money center banks do pay different rates of interest to raise funds. That seems to say that depositors and other creditors do not believe that they are fully guaranteed when they put their money with a big U.S. bank. I would also like to point out that a number of industrial and service companies in the United States, such as IBM, can raise long-term debt at rates that are cheaper than those at which the banks can raise it. This suggests that those investors do not think they have a U.S. government guarantee on bank debt.

As to the question of the antitrust analysis, I believe in the market economy and I believe that banks are not going to choose to go into locations where they do not believe they can make a profit. If that principle is acknowledged and respected, it seems highly unlikely that the number of banks would go from 15,000 banks to three, whether in the next ten years, in my lifetime, or in the next 175 years. It requires a certain speculative perspective to say so, but I would agree that consumers ought to make the decisions.

Bernard Moss, Legislative Consultant to the Association of Bank Holding Companies: Mr. Guenther referred to regional bank holding companies. The membership of my organization overwhelmingly supports a phased

process leading to full national banking. My question is, does the IBA oppose nationwide banking or interstate banking including regional compacts?

Mr. Guenther: Again, I said that if there were full nationwide banking now, the very attractive targets for the money center banks would be banks like Texas Commerce, which are located in deposit rich markets, are very successful, and could probably be taken over fairly easily by the major money center banks. Now I said that would not be pro-competitive.

As to the IBA position on regional banking, there has been a very pragmatic decision, having followed closely the filibuster that D'Amato and Moynihan conducted on the Senate floor last year against the regional banking concept. That filibuster was easily smashed (they picked up only one Senator in addition to Moynihan and D'Amato) and the IBA made the decision that it would be foolish to try to stop regional banking at the national level. Nonetheless regional banking remains a very hot issue for many of my members, particularly in the upper Midwest. So we have created a pool of $300,000 to help states that want to fight regional banking. This is consistent with our underlying principle that states alone have the right to determine their own financial structure.

Susan Alwood, Citicorp: Earlier, sir, you mentioned the Maryland Citicorp agreement that is before the Senate Finance Committee in Maryland and may come up for vote this week. I would like a little reaction from the panel in reference to that agreement.

Mr. Guenther: First of all, it is an agreement between the Governor and Citicorp, and the question is whether it may then be considered an agreement between the state of Maryland and Citicorp. That is the issue before the legislature.

I have a question in return. Should the governor of a state negotiate an agreement with one bank? If that is carried through to its logical extension, what does it mean in terms of a safe and sound financial structure in the United States?

Dr. Feulner: Let me be the devil's advocate for a minute. Is this fundamentally different from the governor of the same state going over to Tokyo, talking to Mitsubishi, and saying, "Build a plant in Hagerstown?" Presumably he is negotiating for the same kind of economic benefits.

Mr. Guenther: Good point. My understanding of the agreement is that

Citicorp will have the advantage of four years on the other money center banks. So Citicorp should be a full service bank and branch statewide, while the Chase will be excluded under this agreement.

Miss England: Actually, under the new amendments to the House bill, which have just come through, the same opportunities would be available to just about any bank meeting certain criteria. But what is the downside to it? Does it hurt anything if it is creating a thousand jobs in an economically depressed area of the state?

Mr. Dabaghi: It may or may not do that. As I said earlier, it is not a bad tactic and obviously very successful in Maryland. However, jobs have been promised by Citicorp in every state in which this legislative duel has occurred. I refer specifically to Florida. Citicorp argues that, if they move in, there will be X number of jobs. But if you add up the jobs, they will not in reality be as efficient: if they do in fact give out all those jobs promised to states, they may not be as good a competitor. This is the premise I question.

Mr. Shaw: I am sorry that there are artificial constraints that force banks to get into markets in such ways in order to serve consumers. But as long as there are those constraints, I applaud Citicorp for showing the way. And further, the Maryland expansion has absolutely nothing to do with safety and soundness. If it did, it would be favorable because it allows Citicorp to expand and diversify in traditional banking areas.

* * *

Dr. Feulner: Our keynote speaker for this mini-conference is well known, I am sure, to everyone in the audience. Having served formerly as chairman of the President's Council of Economic Advisors and currently as chairman and chief executive officer of the economic consulting firm of Townsend-Greenspan, Inc., in New York City, he is a member of the President's Economic Advisory Board, the President's Foreign Intelligence Advisory Board, and the Board of Economists for *Time* magazine. It is my pleasure to welcome Dr. Alan Greenspan.

Alan Greenspan: Thank you. I would like to do something that I think ought to be done periodically on financial institution issues. For whenever we get heavily involved in the basic problems of determining whether a change in a particular state law is good or bad, or whether the federal

government should do this or that, it is important to return to fundamental principles to discern precisely why to do any of this and to determine the standards for judging whether a particular action is appropriate. Presumptions to be made in respect of financial institutions (as also in legislative and economic policy questions in general) are measured against what is good for the consumer, what is good for the country, what is good for the economy, as distinct from what is good for any particular special interest group. The first presumption, then, is that financial institutions exist largely for the purpose of creating services that meet the demands of the consumers. It is consumers who start the process, and institutions are created in order to serve them. It is important to acknowledge this as the precise function of financial institutions, a function that I would like to underscore because the basic premise that underlies all financial institution regulations is that they serve a very special purpose.

Hence, the key question to ask is, in any particular legislative environment, do proposed regulations governing these special purpose institutions actually enhance what they are trying to do, which is, presumably: to create an economic value that has the capacity to reduce the overall risk in a society, which lowers the cost of capital and in effect creates higher levels of investment, higher standards of living, and general economic well-being. Such economic values created by a financial intermediary are essentially those developed through portfolio diversification.

This is not to say that an economy without financial intermediaries cannot function. Indeed, the historic evolution of the intermediary that focuses on what it is that they do and why it is that many of the regulatory inhibitions imposed on them serve no rational purpose, at least to the country at large, proves that such an economy can function. An economy without financial institutions, however, would be one in which savers and investors would deal directly with one another. In other words, rather than deposit my savings (i.e. the difference between my income and consumption) in a depository institution, I would buy common stock or bonds, or a mortgage bond that is a direct claim against the particular physical asset it represents. I might, for example, own shares in the corner grocery store and the mortgage to my neighbor's house. Circulating currency in that environment would probably be either hard currency (e.g., gold and silver) or promissory notes from individuals whose financial reputation and ability to repay were considered unquestionable. That type of economic environment, however, holds a very high degree of risk for any individual holder of a financial asset. As a consequence, interest rates, cost of capital, all the basic risk-laden variables tend to be higher than they would be otherwise.

On the other hand, when intermediaries buy up a bundle of mortgages, bonds, or common stocks, creating a diversified portfolio, and then sell claims against my institution, this process generates insurance potential. Then it becomes safer, if I am able to convince you as a depositor to purchase a claim against my institution, which owns this diversified group of instruments; for your deposit in my institution draws an interest rate that is less than the rate of return on my portfolio. This spread, which is the difference between what I am getting on that portfolio of so-called primary securities and what you are willing to accept as a much safer interest rate, is an economic value created essentially out of a reorganization of financial assets, a value directly owing to diversification. It creates a lower cost of capital, because, to the extent that I am a new player in the market and willing to move into the market, it will tend to lower the rate of return and increase the price on the primary securities involved. In so doing, it will lower interest rates generally, and the spread between this lowered rate and what I paid to depositors is the value added of the economic service being produced. And if I can produce that service at a cost that is less than that value added, I will make a profit.

Again I will make the point that there is profit in an unregulated, unfettered, fully competitive financial system only if a service is supplied that consumers or business wants: it simply cannot be done if the service is not wanted. What may happen is that there is a spread between the portfolio and the deposit interest rates paid, but it may not be enough to defray the expenses of other resources needed to create that service. And I would add that, provided there are no government subsidies involved in the system and there are no legal barriers to entry, the only way to make a profit in a financial industry where assets can be moved almost instantaneously is to create a real service bringing higher interest rates directly to consumers, more than they would otherwise get in a safer environment.

Because the sources in this industry, unlike nearly any other industry, can move almost instantaneously, any form of suppression of freedom of entry into financial institutions that prevents the fully competitive system from working (which is what a broad group of regulatory notions do) essentially induces a foregoing of economic value to somebody in particular and to the economy overall. I cite McFadden, among others, as evidence of an overwhelming, counterproductive force which is, nonetheless, argued to be regulatorily desirable. My own view is that I have never seen a constructive regulation yet, but I at least grant the conceptual possibility of one for the purposes of this argument.

In answer to an argument in favor of certain regulations, however, it is interesting to note that the expansion of banks and other intermediaries

has in fact been dramatically inhibited. This failure to behave in a market-oriented manner may be explained in various ways, some of which I think are probably valid (granting that certain regulatory activities were more exactly subsidies), and some of which are not. There is, for example, a very strong anticompetitive attitude among a number of our state-protected S&Ls, small commercial banks, and others, which is the result of a direct subsidy, which subsidy, I suspect, does not serve the national interest. For when deposit insurance is introduced into this type of economic environment, it effectively breaks the string of a fully competitive, unfettered open market system.

If a state charter is obtained for a commercial bank or a savings and loan, and in the process, federal deposit or FSLIC insurance, there is an extraordinary capacity to sell liabilities—mainly deposits—at a government-guaranteed rate, meaning that it is much cheaper and easier to accumulate funds concurrently. Those monies can then be used to invest in financial instruments in the local area, probably because quasi-monopolistic elements within a lot of small communities produce a fairly high rate of return. In that type of environment it takes a great deal of imagination to figure out a way to lose money. And, in fact, it is very difficult to find actual situations where someone has lost money, at least until recently. For once depositor insurance has been introduced, which in a sense very logically puts the government in the position of "If I give you this deposit guarantee, I should therefore have the right to audit, control, and essentially maintain where your assets can be loaned," a problem is generated that is terribly difficult to dispel.

Prior to the creation of federal deposit insurance, any small institution starting from scratch had great difficulty attracting deposits until it had established a reputation of soundness, safety, and reliability, which took a number of years. Federal deposit insurance now bypasses that system at considerable cost. It has taken fifty years to see what the books look like, and it is not an accident that there are now depository institutions that, in the case of the S&Ls, have no tangible net worth on balance. Running those institutions is like running a car on a pothole ridden road without any shocks. There is no capital to interpose itself between the liabilities and the assets, no capital to offset any problems in the assets affecting the liabilities or vice versa as far as S&Ls are concerned. Anything with such an immediate adverse impact has an effect on the institution and the system. So it is apparent when looking at the S&Ls that the situation is pretty miserable.

In comparison, the commercial banks on average look better, but even they are not doing inordinately well, largely because the quality of loans

that the commercial banking system has been getting over the last couple of decades has clearly deteriorated. Viewed in the context of a decline in bank capital asset ratios (which went down fairly sharply in the 1970s and have barely risen since) and in comparison to the healthy status of the nonfinancial corporate balance sheets, it would seem that the ratio of short-term debt to long-term debt has been rising almost progressively for the last twenty years and that the ratio of equity to debt has declined significantly. This ratio has not really recovered in recent years at all: in any measurable sense it is quite low. That basically means that the quality of the borrowings made by those institutions must have declined, unless there has been an extraordinary offset on the part of lending officers of banks. However, I have observed no evidence of this.

In addition, the larger nonfinancial corporate institutions—those with the least risk involved, the best balance sheets—are moving their short-term borrowings to the commercial paper market. They are leaving the sludge of the loan markets for the commercial banks to finance. So, if there are a multitude of loan problems in these commercial institutions, it is for the most part inevitable. The question is, which of these institutions have the capacity to avoid making such short-term loans.

Finally, the combination of the banks' own balance sheets deteriorating simultaneously with the deterioration of their customers' balance sheets clearly gives rise to many difficulties that would not exist for the bank if one could somehow wave a magic wand and double the capital in the banking system.

The difficulty with all of this is that it has created problems which, though they would have surfaced under any conditions, are nonetheless particularly difficult because of the banking industry's thin capital margin. Although there are many things wrong and many reasons for the wrongs, deregulation had nothing to do with them, for the current problems started well before the start of deregulation. Today's problems are fundamentally the result of structuring institutions with long-term assets and short-term liabilities—institutions such as the S&Ls, which are viable only in the context of low interest rates—and a fundamentally noninflationary type of system. Unfortunately, statisticians are especially prone to say, when they see a correlation between A and B, that B is therefore caused by A. This sometimes may be true, but correlation does not necessarily indicate causation and, in the case of deregulation causing current problems, I suspect it does not. On the contrary, the beginnings of many of the problems that are emerging now could be seen well before any discussion of deregulation.

Now in an effort to analyze all the various elements of financial institu-

tion problems, these elements must not be confronted on a piecemeal basis, assuming that the deregulatory activities that have occurred to date and those being contemplated are issues fundamental to the problems being dealt with. Such assumptions would make the problem worse, not better. Careless assumptions also distract attention from another fundamental problem, which is inadequate capital in the system—but this is a different issue. If it continues to be a game regulating this and regulating that, the problems will escalate without any indication of what is creating them.

In my judgment, further deregulation, such as the repeal of the McFadden Act and Douglas Amendment, would probably go a long way toward improving the situation. Indeed, what is necessary to solve the problem effectively is the freedom of greater diversification for depository institutions so that they can reduce their overall risks. It is obvious that the inhibitions still imposed on interstate banking prevent the maximization of diversification and the reduction of risk, and in that sense these inhibitions, which serve no useful purpose and indeed are probably counterproductive, are creating additional problems for the depository institutions.

Now I have no doubt that, if interstate banking is instituted, there will be fewer banks, and there should be. The number of banks in this economy is much larger than makes sense, and this excess basically has been caused by an anticompetitive regulatory structure of the last fifty to one hundred years.

This is not to say that there is a possibility of coercive monopolistic financial systems. There is no way to do that in a financial market where there is free entry of capital and four basis points will draw $100,000,000 from one deposit into another.

Additionally, there is no evidence that concentration would result, as Steve Rhodes of the Federal Reserve demonstrated by comparing the differences between states with fairly extensive branching authorities and those that are highly restricted. What he found was that those with restricted covenants about branching had a higher concentration of bank ownership. However, when viewed from the local level, he found that the concentration is independent of the state regulatory statutes in that there may be relatively few institutions—or fewer institutions—in the state but each has branches in every locality, and they are all competing against each other. Hence there is no way to create a monopoly, and unless it can be demonstrated that there is a monopoly profit in that type of environment, it cannot be argued that the consumer is being hurt.

Moreover, there is no evidence that there are economies of scale in

banking; in other words, that larger institutions somehow do better than smaller institutions. On the contrary, the evidence suggests that the smaller institutions fare better and, therefore, there is no evidence to suggest that the small commercial bank, operating with local knowledge and fairly good relationships with the community, has anything to fear from Citibank or anybody else who wants to move in. In fact, when Citibank tried expanding in upper New York State, they found that some of these "hick" bankers were just too much for them to handle. This teaches something quite significant and illustrates the point that basically this is a situation in which understanding the particular processes precisely is very important.

In summary, let me just say that if deregulation is considered potentially dangerous, the centrality of the whole structure of financial institutions has been missed; and unless the focus is on where the problems lie and finding the right solutions, depository institutions' difficulties will continue. Let me emphasize again that, in the final analysis, deregulation has been terribly helpful; its enactment has been forced by a number of crises in our domestic depository institutions. It would be a terrible tragedy if, in the fear that somehow the problems are associated with deregulation, the clock were turned back for more regulation or the process of deregulation stopped in its tracks.

Guest: Dr. Greenspan, on a recent appearance on ABC's "Nightline," you were asked to comment about whether Citicorp or some similar institution should be allowed into Ohio to acquire an Ohio S&L. Now that Citicorp seems poised to do that, are there any negative, far-reaching implications here for the state of Ohio or for the banking industry as a whole?

Dr. Greenspan: No, on the contrary, there are no downsides. No one else wants to pick up those moribund assets, and I suspect (even though I am a director of a competing bank) that Citicorp is likely to add quite significantly to the viability of the financial system of that state. As indicated earlier, I see no particular problems in breaking down interstate banking barriers or, in fact, interdepository barriers or depository institution barriers. So I think it is all to the good, and that it has taken this long seems totally unnecessary.

Guest: Would you care to comment about the relationship between a very loose and not irresponsible fiscal policy running over a period of years and its effect on the interplay, or lack thereof, of the financial institution sector?

Dr. Greenspan: At the moment, it has not had any significant effect. And I think that is largely because of the very substantial flow of time savings into the American system. It started from scratch a few years ago, and it now accounts for 25 percent of net credit availability, which is essentially offset by an unacceptable and undesirable federal government deficit. Eventually this deficit will create an unstable financial system characterized by both higher interest rates and higher rates of inflation. That, needless to say, will create very significant problems for the savings and loan industry, assuming that there is no solution between now and then. It also will affect many smaller commercial banks whose balance sheet looks like savings and loan balance sheets and any institution that is in trouble when interest rates rise, which includes a large number who have a mismatch between assets and liabilities. So I would say that any financial institution that had a heavy emphasis on mortgages or a mismatch between the maturities of assets and liabilities should be quite concerned about its future unless its problems were brought under control.

Guest: With the problems in Ohio, it is being said that deregulation does not work and that federal insurance is the answer. My question is what do you think is the most effective way to respond to this so that we do not eventually fall back into the dilemma we now face in Ohio and we do prevent the possibility of going in the other direction and imposing more regulations in a more restrictive fashion.

Dr. Greenspan: Your question raises what I like to call the Achilles' heel of financial systems, which is federal deposit insurance. Accepting federal deposit insurance places the system in a very tough position. The reason is that once there is federal deposit insurance, which is insurance from the sovereign who has the capacity to print money, there is no way that a competitive private insurance system can exist. It is the same problem as that in mathematical probability, which states, if you try to go into a dice game with somebody who has unlimited resources and your resources are limited, you will eventually lose. In the same way, though the analogy may not be precise, federal insurance will drive out private insurance. I am not sure how to approach this problem except to try to find a mechanism by which to increase the capital of the institution, my reason being that the only substitute for deposit insurance that I know of is increased capital. If there is a depository institution whose capital is 90 percent of its assets, deposit insurance is unnecessary and, in fact, irrelevant. If, however, the capital comprises only 3 percent of the assets, deposit insurance does seem necessary. The only way that I can see to respond to this

problem in a way that does not nationalize the system, which is essentially the current direction, is to find a means to substitute capital for insurance and diffuse the issue. At some point I would like to see a system with no federal deposit insurance at all. I do not expect to see that, but I am not the only one opposed to the whole issue of federal deposit insurance.

Guest: Is this a Catch-22? It seems the best way to move the system toward more equity and more capital as a basis for private insurance is to start phasing out federal deposit insurance or of course deregulating the system. Do you see any other possible way of inducing banks to start looking in that direction?

Dr. Greenspan: Not under existing legislation. Of course, to find the mechanism to make private insurance work would be fine, but it is a tough thing. In principle, I would like to see that and indeed, I might add, that where federal deposit insurance is not available, there is a huge amount of private deposit insurance. A lot of companies basically insure and thus evaluate each other. What exists is a cross insurance of one institution versus another; it seems a terrible mess. But the system does have the unique characteristic of reducing overall risk.

What I am saying is that at the moment there is no satisfactory solution, and inevitably there must be changes in the depository system—the insurance system which we now have—which is at this moment undefined. I do not know whether or not I take seriously the $100,000 limit on deposit insurance or that very vague statement by the FDIC and the Fed that Continental was basically supported because it was one of the ten largest bank holding companies. If that is the case, where the largest institutions are fully insured, but the smaller ones are not, there really is not an articulated federal deposit insurance system. Existing laws are ambiguous, and the nation is riding more on economic hope than on anything that resembles sound statutory or economic principles. It is just a matter of time before something extraordinary is going to happen and it will be known that there is great ambiguity about what can or cannot be insured through the federal government. One thing I am certain of is that the FSLIC fund has something like $6 billion in assets and the FDIC fund has a little more than three times that. Having to presume that the assets in some way relate to the insurance of the system, I think, is silly.

Guest: Would a major infusion of foreign capital into the American banking system help or hurt the system?

Dr. Greenspan: First, it is important to remember that, when foreign institutions come in, they are under American law and are American institutions with foreign owners. The way the London market works is impressive, yet it is hard to find a British bank in London. Americans, and to a lesser extent the Japanese, dominate those markets. I know of no problems that exist as a consequence of that. Major service entities within the London market could have been created to the good of the British economy. My view is that if foreign capital can be induced to come here and assist on this capital problem in our depository institutions, provided they come in under American law, I see no problem at all. In fact, I think it is inevitable.

Guest: Dr. Greenspan, I am having a difficult time understanding the philosophical approach that you and The Heritage Foundation adhere to, and I have a question. Why is it that conservatives seem to view any demand by the market for services as valid and any attempt by private enterprise to meet those concerns as good, but on the other hand, it seems that any demand by citizens of their democratic system to provide deposit insurance or other concerns is viewed as out of order and wrong?

Dr. Greenspan: I will not speak for The Heritage Foundation, but let me rephrase your question in my terms, and if I put it incorrectly, please let me know. The basic problem is whether or not citizens within a free society deal with one another in terms of voluntary actions for their mutual benefit. That is, what are conservatives oriented to philosophically, as a fundamental proposition relating to the appropriate relationship amongst citizens in a free society?

Government is viewed as a vehicle whose primary role is to maintain the society so that individuals cannot obtain those values through the initiation of force or fraud. When the force of the state is employed, in effect society is induced on the part of a minority of individuals in society. Values are extracted from them which they would not be willing to give up voluntarily. Assume a wholly democratic society in which there is no protection of individual rights—in which any majority vote by the society legally binds everybody else. That means, in effect, that 51 percent of society can enforce its will on the rest. Now if nobody really wants that society, the question then becomes what are the limits on what the government can do to an individual. In our society, the Bill of Rights has endeavored to define what those areas are in which the government cannot impose itself on individuals. Government has fundamental limits. The differences between conservatives on deposit insurance issues get to

this very fundamental question: Whether or not the use of the police power of the state, which is fundamentally what all legislation is, appropriately extracts benefits from the minority of the society which are not given voluntarily. So that when deposit insurance is stipulated by federal regulation, what in effect is happening is the use of the power of the state—its sovereign ability to manipulate the currency. For deposit insurance basically is supported by the full faith and credit of the sovereign, which means that in the event of losses monies are extracted from everybody in the society by means of creating additional debt instruments. And the key question is who has the right to take from individual members of the society against their will—to, in fact, induce that form of deposit insurance. What I am saying is, yes, there is a fundamental issue here that gets to the very core of the way a free society functions, because deposit insurance is essentially the use of the sovereign taxing and money-printing process of the state. Enforcing legal tender on those monies basically enforces the confiscation of goods and services for the purposes of the state without the voluntary consent of the individuals involved. Now I will acknowledge immediately that all taxation is the same, and there are very few conservatives who are against all forms of taxation, which is a problem for conservatives. I doubt very much if there is the capacity to come to grips with this in a really fundamental way. Therefore, I suspect the debate is going to appear to be a "them against us" type of debate, which will preclude a profound discussion of the question. It is long overdue, and deposit insurance offers all the characteristics of the really fundamental choices that have to be made.

Guest: Last summer, you spoke of the need to write what you called the constituents' juggernaut on the Hill in an effort to avert the long-term disaster associated with a long-term budget deficit. Do you have any comment now on the way the process is currently running and your long-term views?

Dr. Greenspan: It is running poorly. I think that the Senate Budget Committee mark-up was an extraordinary demonstration of how difficult it is for a democratic society of the type we have to repossess benefits previously bestowed to constituents. And in my judgment, it cannot be done except with an up or down single bill, which probably means that some form of compromise agreement must be effected between both Houses of Congress and the White House, in which the President, Speaker, and Members of the Senate and the House would all have to sign off on a very specific line-by-line budget. They would have to agree on

that, recognizing that it is not a particularly desirable package for anybody (in fact, if it were desirable for any of them, it would not work). It has to be a distribution of negative benefits, so to speak, for everybody. Only that way can this issue be resolved. I doubt that it can be done otherwise. So I would say that regrettably nothing has happened in the last nine months except a reaffirmation of the fundamental institutional difficulties in resolving these issues.

Dr. Feulner: Thank you very much, Dr. Greenspan.

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The Heritage Lectures

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Reagan Administration moves to deregulate banking have been met with concern by some and enthusiasm by others. Many small community banks fear that deregulation will spur out-of-state takeovers. Yet many experts argue that the real enemy of small banks is regulation itself. Only through the competition generated by liberalized laws, insist these experts, can small banks cope with changes in the system. Regional compacts among states, a logical first step toward broad interstate banking, allow banks outside the major money centers to consolidate and grow stronger before they are exposed to competition or takeover attempts by the nation's largest banks. Big banking, understandably, opposes the regional approach.

To explore these divergent views, The Heritage Foundation assembled a panel of experts, both bankers and analysts. Although they leave the reader to decide which strategy will serve consumers best, their lively and informed discussion sheds much light on an important legislative controversy. There is no doubt, however, that in banking as in most other sectors of the economy, regulation does more harm than good and ends up as higher costs to the American consumer.

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