THE ANTI—COMPETITIVE COMPETITIVE BANKING BILL

It seems that no one wants to miss out on the newest fad in Washington--competitiveness. The nebulous term is now routinely attached to legislation, much of which would do little or nothing to improve America's competitive position. One of the latest examples is the misnamed Competitive Equality Banking Act of 1987 (S. 790), which has been reported out of the Senate Banking Committee and is scheduled for debate in the Senate this week. Instead of enhancing the international competitive position of commercial banks, the bill actually takes a giant step backward by barring federal regulators for one year from granting banks the right to deal in securities, real estate, and insurance. Furthermore, the bill places sharp restrictions on limited service "nonbank banks," and misses an opportunity to reform the weakened savings and loan industry. In short, instead of enhancing U.S. competitiveness in financial markets, the legislation would inhibit it.

The Glass-Steagall Act of 1933 separates banking institutions into investment banks, which underwrite stock offerings and deal in securities, and commercial banks, which lend money and maintain demand deposits. Interstate banking is also prohibited under federal law, unless a state specifically invites a bank in. Commercial and industrial business unrelated to banking is also barred. Yet these barriers are rapidly becoming obsolete under the pressures of new technology, changing customer demand and worldwide financial markets. For instance, firms such as Sears Roebuck and General Electric now provide various financial services including insurance coverage and commercial loans. The emergence of such limited service "nonbank banks" increases consumer choice and helps keep prices competitive. S. 790 would block expansion of such services for one year--to the detriment of the consumer.

U.S. commercial banks are even prevented under current law from competing effectively against certain European and Japanese banks within America's borders, since a number of foreign commercial banks are exempt from Glass-Steagall investment banking restrictions. These foreign banks now provide over 20 percent of all loans made to U.S. businesses and are increasingly active in domestic corporate debt and

equity underwritings. Moreover, since other major countries do not impose such tight restrictions on banks, the underwriting business is leaving New York for friendlier shores.

To its credit, the chief regulator of the banks, the Federal Reserve Board, does recognize the anachronistic nature of the current banking laws. The Fed is taking steps to allow banks to diversify along product and geographical lines. State banking regulators have also begun to loosen up the limitations placed on state-chartered banks. The New York State Banking Department, for instance, ruled recently that state-chartered banks could begin to underwrite corporate securities. But it is unlikely that the Fed or the states can single-handedly undo what has been law for over fifty years. That would require leadership from the Senate Banking Committee. Unfortunately, S. 790 shows that the necessary leadership is lacking. The bill would prevent the Fed from undertaking any further reforms for one year, signalling the unwillingness of Congress to modernize America's banking laws.

The committee bill also addresses the troubled savings and loan industry's federal insurer, the Federal Savings and Loan Insurance Corporation (FSLIC). S. 790 would establish a Financing Corporation authorized to borrow up to $7.5 billion in the capital markets in line with a plan developed by the Treasury and the Federal Home Loan Bank Board. But the $7.5 billion would not even begin to meet the needs of FSLIC. A recent General Accounting Office audit showed FSLIC to be in need of at least $25 billion to meet its commitments. Yet by seeking to maintain thrifts as a separate type of financial institution, the Banking Committee's "Recap Plan" offers no long-term solution to the thrift industry's problems. Congress should recognize the erosion of this distinction and allow stronger thrifts to either obtain their insurance from the Federal Deposit Insurance Corporation (FDIC) or to be acquired by well capitalized buyers.

The Competitive Equality Banking Act actually inhibits competition and preserves inequality. Rather than facing up to the fact that the antiquated banking laws of the New Deal have no place today, the Senate Banking Committee is merely burying its head in the sand. Only increased competition between commercial, investment, and nonbank banks will reduce customer costs, stimulate efficiency, and enhance America's competitiveness in world financial markets.

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For further information:

Burt Ely, "Confronting the Savings and Loan Industry Crisis," Heritage Foundation Issue Bulletin No. 126, August 13, 1986.

Deidre Fanning, "Set U.S. Free," Forbes, February 23, 1987, pp. 94-96.