REMARKS OF THE ATTORNEY GENERAL
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Americans have always proudly proclaimed the virtues of the free enterprise system -- and the historically unparalleled prosperity and upward mobility that it has made possible. Nevertheless, there has also always been a populist strain in America critically commenting upon the invisible hand of capitalism. The American banking system has experienced both.

President Lyndon Johnson used to tell the story of a man who collapsed and was taken to a famous Texas hospital. There a cardiac surgeon informed the man that his heart was just about worn out. The Doctor, however, offered one hope -- a heart transplant.

Two donors were available. One was a young accident victim struck down in his prime as he was preparing for the olympic games as a sprinter. The other was less promising -- an eighty-year-old man who had been a banker all his life.

The patient surprised his doctor by immediately agreeing to the operation -- and to accepting the deceased banker's heart.

"Why," the surgeon asked, "would you prefer the eighty year old banker's heart over that of the young athlete?"

"Well," replied his patient, "I figure that an eighty year old banker's heart has suffered less wear and tear because it probably hasn't been used much."

Like the patient in that story, some in government seem to believe that our capitalist system has no heart. Like most Americans, this Administration knows better. We recognize that, in a free enterprise system, success flows from the businessman's responsiveness to the needs and desires of the consuming public. We do not believe that government bureaucrats know better than the public what people should desire.

Some years ago, the Governor of my home State used to tell audiences:

> "I always grew up believing that if you build a better mousetrap, the world will beat a path to your door. Now if you build a better mousetrap the government comes along with a better mouse."

That speaker is now President, and he still believes government should foster rather than discourage new and beneficial commercial initiatives.

This country was built by men and women who prized the freedom that made possible an ever-increasing prosperity. This Administration intends to foster the freedom that makes enterprise possible -- and the competition at the heart of free enterprise. The Department of Justice and its Antitrust Division have a special role to play in that effort.

Our nation's banking industry and the antitrust laws enforced by the Department of Justice share a common ancestry. The National Currency Act of 1863 established the core of the banking system we have today. It was introduced in Congress by a Republican Senator from Ohio named John Sherman, whose name is associated with our basic antitrust statute, the Sherman Act. We believe today that revisiting this common heritage and applying the competitive principles enshrined in the antitrust laws to the banking industry would result in improved market performance, benefitting bankers and depositors alike.

The banking industry is in the midst of a revolution, spurred by the technological innovation of the computer age as well as the economic uncertainties of the past several years. While this revolution is ongoing, its momentum has been slowed by outmoded and largely unjustified regulatory barriers to competition in the banking industry. Those barriers have directed the creative energies of businessmen away from competition on the merits and toward schemes to avoid regulatory silliness.

For many years the Department of Justice has argued for increased competition in financial markets -- and against excessive regulation. We have spoken out in various regulatory forums. Recently, the Department has urged the Federal Reserve Board to permit bank holding companies to acquire thrift institutions. We have urged

the Depository Institutions Deregulation Committee to permit market forces to determine as quickly as possible the rates institutions will pay for deposits. We have also supported the Federal Home Loan Bank Board's policy of permitting interstate savings and loan acquisitions of troubled institutions.

While some restrictions are easing, much more remains to be done. Many regulations needlessly interfere with the free play of competitive forces which, when left alone, lead to the efficient use of resources, and better products at lower prices for consumers.

Obviously, there are situations where regulation may be appropriate. For example, the dynamics of a market may lead toward a structure where effective competition will not develop. This is often the case with perceived natural monopolies, such as local gas, electric, water, and telephone service. More often, however, legislatures make policy decisions that particular individuals or groups should be shielded from the forces of competition. When they do, regulation, while certainly not desirable from a competitive perspective, becomes inevitable.

Even then, however, competitive principles remain relevant. Appropriate analysis entails identifying the purposes behind the particular regulations; assessing the effectiveness of the regulations in achieving those purposes; recognizing any unintended costs that those regulations impose; and determining whether there are any less costly and more efficient means of achieving those same goals.

With this approach in mind, I would like to discuss regulatory restrictions on entry in financial markets, and, in particular, the major restrictions on interstate banking today -- the McFadden Act and the Douglas Amendment to the Bank Holding Company Act of 1956.

It is clear why Congress and state legislatures have felt that extensive regulation of banking is appropriate. In most industries, the process of entry and exit disciplines the market's performance. Competitors are forced to provide products or services at affordable prices that satisfy consumer desires. They know that if they do not, other firms can enter the market and attempt to meet the need. If a firm fails to satisfy consumer desires, the judgment of the market can be swift and unforgiving. The firm's business plummets

and it eventually either does better or goes out of business. There is nothing like the prospect of imminent failure to focus one's attention. Competition prunes away the inefficient, prods the successful, and opens the way for new competitors with untapped energy and fresh ideas.

As we learned in the Depression, the social cost of a financial institution's failure can be much higher than with other enterprises. A bank may lose not only its own money, but also the savings of its depositors. As a result, the federal government has become, in a sense, a partner in the operations of every insured institution. It therefore cannot sit benignly by as the market metes out stern punishment to inefficient banks. Sudden failure is unacceptable in banking. The need to guard against the deleterious effects of sudden failure on depositors and on depository insurance corporations explains many of the regulations imposed upon financial markets.

Restrictions upon entry are among the most significant of the restraints that have been adopted. It is, however, a naive notion that limitations on the number of banks competing in a market will protect the existing banks from "too vigorous" or "destructive" competition.

Surely, attempting to guarantee the satisfactory performance of financial institutions by keeping potential entrants out seems peculiar. It has been said that this is like limiting the number of farmers to ensure the healthfulness of milk. The restrictions do not promote efficiency. They promote the continued survival of the inefficient by carving out enclaves where weak banks will be protected from the rigors of free and robust competition.

Increased efficiency and better performance are foregone as a result of preventing new banks from attempting to snatch business from the inefficient. One early study concluded that entry restrictions cut in half the number of new banks chartered between 1936 and 1962. Had double the number of banks vied for customer's deposits through those years, increased efficiencies and innovations could have resulted.

There are certainly other ways to safeguard the health of financial institutions besides strict limits on entry. Failure does not have to be sudden, and does not have to threaten an entire institution. Unprofitable

branches of otherwise healthy institutions can be closed with little adverse public effect. Smaller banks confronting difficulties which cannot be solved by scaling back operations may be able to withdraw from the market without serious repercussions before their problems become too severe. The extensive bank examination programs currently in place can aid tremendously in promptly identifying problem institutions. Often the best solution is acquisition by healthier organizations. This type of affiliation can often infuse a troubled bank with more capable management and may allow it to take advantage of economies of scale.

As you know, a common difficulty in arranging these affiliations is presented by the limitations presently imposed on the geographic expansion of banks. Restriction on interstate branching often means that the only banks able to absorb troubled institutions are ones which compete in the same market. Indeed, a local institution may be willing to pay a premium to acquire a local troubled institution in order to strengthen its position in the local market. Moreover, a regulator may be willing to accept this result because the premium will reduce the level of financial assistance required from the government. While this may be a short-run gain for the deposit insurance system, it is a significant long-run cost for the public and obviously raises serious antitrust concerns.

Regulatory control over the branching authority of national banks is not a new issue. In the historic decision of McCulloch v. Maryland, Chief Justice John Marshall in 1819 addressed the branching powers of the first Bank of the United States. He stated: "The great duties of the bank are prescribed; those duties require branches, and the bank itself may, we think, be safely trusted with the selection of places where those branches shall be fixed; reserving always to the government the right to require that a branch shall be located where it may be deemed necessary."

Much has come and gone in the banking world since 1819, of course, including the first and second Bank of the United States. The modern history of the federal prohibition on interstate banking dates from passage of the McFadden Act in 1927. Before McFadden, national banks were prohibited from branching by an interpretation of the National Currency Act of 1863. The Act was conceived as a liberalizing measure, for it allowed national banks to branch within their home cities for the first time, so long as state banks in those

cities were empowered to branch as well. The Banking Act of 1933 broadened this authority by allowing national banks to branch statewide, but again the legislation extended no greater branching power than was enjoyed by state-chartered banks in the same states.

Interstate expansion itself is also not a new issue. The Senate version of the bill that became the 1933 Act advocated free branching, at least within trade areas. The rationale for permitting such expansion was clear. Over 5,000 banks failed during the 1920s. Approximately 90 percent had assets of less than $1 million. Between 1930 and 1933, nearly another 9,000 institutions, again mostly small unit banks, suspended operations. It seemed time then to permit healthy banks to expand interstate into areas where weaker banks had failed. Representatives of smaller banks loudly expressed their hostility to the increased competition that would have resulted, however, and a compromise permitting only somewhat liberalized intrastate branching occurred.

The McFadden Act, the 1933 Banking Act, and the Douglas Amendment to the Bank Holding Company Act, which prohibits a bank holding company from acquiring a bank in another state unless the laws of that state specifically allow it, all erect barriers to the national expansion of banking. They subject the branching powers of national banks to the limits imposed by the various states. Thus, a regulatory innovation adopted more than five decades ago has calcified into an extreme restriction in 1982.

The prohibition on interstate banking reflects in part a suspicion of large, big-city banks and concentrations of financial power long evident in our national character. This suspicion was dramatically made manifest one hundred and fifty years ago, when President Andrew Jackson, who had a deep and abiding distrust of banks, vetoed the rechartering of the Second Bank of the United States. The populist sentiment underlying the veto can be gathered from the judgment of a contemporary Jackson supporter, who said, if Jackson "can exterminate this aristocratic monster -- this bank hydra -- and rear upon its ruin a people's bank, an institution of which the people can reap the profits ... they will give greater luster to his character as a statesman than the battle of New Orleans to his fame as a warrior."

It might seem to follow that antitrust policy, which to a degree also grew out of populist sentiment, would likewise counsel against the establishment of large

banks with far-flung offices. There is, however, nothing inherent in the notion of interstate banking that runs counter to antitrust policy. To the contrary, the present system of geographic limitations constitutes a regulatory intrusion upon the free workings of the market. Indeed, the purposes and effects of the restrictions show them to be unjustified.

What were the goals in prohibiting interstate expansion? The first goal, a residue of the Jacksonian legacy, was the prevention of a perceived undue concentration of financial power. There are, however, about 14,000 banks in the United States. Neither market concentration nor aggregate concentration is a serious prospect. As for cartels or mergers, the antitrust laws themselves are sufficient to prevent any anticompetitive market concentration from those sources without artificial regulatory barriers.

Moreover, McFadden's restrictions can sometimes work in ways directly contrary to antitrust concerns -- and even contrary to McFadden's own purpose of preventing undue concentration. For example, when a bank is in precarious condition and can be saved most efficiently by merger with another stronger institution, McFadden will prevent merger with an out-of-state bank. As a result, the only possible merger partner may be one of the bank's competitors. Thus, McFadden's restrictions can cause an increase in banking concentration in the local market, which might otherwise have been avoided.

Indeed, although McFadden may to some degree reduce the aggregate concentration of financial resources on a national scale, it does so by increasing market concentration and lessening competition in local banking markets. And for the ordinary consumer the competitiveness of the local markets -- the institutions to which he can turn for the full range of banking services -- is critical.

The second goal in prohibiting interstate expansion, somewhat related to the first, was the fostering of a market structure where decisions affecting the financial needs of communities would be made at the community level to the extent possible. Some have feared that, with elimination of the McFadden Act, branches of national banks would suddenly mushroom in every city and hamlet, devouring all local competition to the extent that any small businessman who needed a loan would have to win over some unknown banker in a distant financial center. I do not believe this fear to be well founded.

To the extent community banks are best able to serve community needs, they will continue to survive and prosper. If they should lose business, it would likely be because consumers in the community choose to take their deposits elsewhere. From a competitive standpoint, this outcome should not excite alarm.

A third purpose that the continued vitality of the McFadden Act serves is deference to the sovereign power of the states. National banks are unable to open interstate branches because the individual states have not allowed their statechartered institutions to do so. Since the federal legislation defers to the states in this area, federal policy would be changed by a shift in the policies of the states. There is nothing in the concept of interstate branching itself that appears inconsistent with the principles of federalism. Nevertheless, the failure to take federal action to permit interstate operations may in part be explained by the historical fact that policy in this area has traditionally been established at the state level.

How effective has the regulatory scheme been in actually preventing interstate banking from occurring? On this score, there can be no doubt that the Act has not been fully effective and becomes dramatically less so every day. It has been reported, for example, that the Bank of America has offices in more than 40 states, and confronts Citicorp, among others, in most of them. Indeed, the only interstate banking that the McFadden Act effectively prohibits is the taking of retail deposits. Loan production offices, Edge Act corporations, and other carefully crafted structures have long allowed banks to conduct wholesale business on an interstate basis. The movement of bank holding companies into the consumer finance business has permitted banks to engage in retail banking on the credit side on an interstate basis as well. Thus, only in the case of retail deposits have banks been unable to take advantage of whatever economies and efficiencies could be realized by interstate banking.

Recently, Automatic Teller Machine networks have suddenly emerged -- and there is much talk of establishing such systems on a regional and even national scale. As a result, the electronic revolution has subjected even retail deposit taking, the last stronghold of exclusively intrastate banking, to the pressures toward large-scale operations. The rapid development of ATM networks is clearly an important and exciting development. It is a development that the Justice

Department will watch with considerable interest in the years to come.

The McFadden Act, then, has not successfully prevented interstate banking. Its primary effect has been to influence only the structure of the organizations through which banks carry out interstate business.

On the other side of the ledger, what regulatory costs has the McFadden Act imposed? The prohibition on interstate branching has prevented customers from taking advantage of the innovation interstate competition may engender. This clearly is important in an antitrust analysis.

In addition, the less obvious costs to the banking industry have become dramatically more apparent in recent years. The McFadden Act prohibition impairs the ability of banks to take full advantage of new technologies that can most efficiently be applied on an interstate basis. It also imposes unnecessary administrative costs. Banks have been forced to structure their activities not on the basis of efficiency but in order to conduct as much interstate business as possible without running afoul of the statute.

During the last decade foreign firms have greatly increased their presence in U.S. banking markets. Traditionally, foreign banks were not subject to McFadden Act restrictions. A startling anomaly resulted. Foreign banks enjoyed a pronounced advantage over their U.S. rivals in establishing interstate operations. Congress responded in 1978 by passing the International Banking Act. Rather than loosening the regulatory shackles on domestic banks, however, the statute imposed similar restrictions on foreign banks. Nevertheless, forces of competition have erupted from a new source.

In recent years, the competition that nondepository institutions pose to banks has grown beyond all predictions. These nondepository institutions -- such as Merrill, Lynch and Sears -- do not labor under geographic restrictions. They can make full use of economies and efficiencies flowing from interstate operations. They therefore have a significant advantage over their banking competition. This development dramatically highlights the fact that geographic limitations impose substantial costs on the banking industry as a whole. It demonstrates once again that artificial regulations can delay but not stem the tide of competitive forces. They can only channel those forces toward other, usually less efficient, outlets.

Like so many regulations directed against natural competitive forces, the statutory restrictions on interstate expansion impose public costs that outweigh their benefits. The costs of the restrictions are apparent. The benefits, if any, are more difficult to identify. To the extent that we desire to prevent the undue concentration of financial power, I believe that the antitrust laws are fully adequate to achieve that goal. To the extent that the restrictions are seen as a way to preserve a system in which financial decisions are made on the local level, I believe that they are unnecessary. Consumers are best able to choose the size of the financial institutions with which they deal. With this fairly dismal scorecard, an appraisal seems warranted as to whether federal action in this area is appropriate. In any case, it is time to reconsider these geographic restrictions on banking as they operate today. By any objective analysis, they are not in the best interests of financial institutions and consumers. Competition would once again better serve the public interest.