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In thinking about any problem, the first thing is to try to separate shadow from reality, lest one attempt to solve the wrong problem. In political terms, the best illustration of this state of affairs is the Electoral College. Everyone knows that the President is elected by the delegates chosen for the Electoral College, but the reality is that we all learn the name of our next President from the evening news broadcast weeks before the Electoral College even meets. The federal legal framework is untouched and functioning, but the reality of the political marketplace has overtaken it.

The financial service business is also subject to this same shadow and reality phenomenon. Federal laws and regulations are in place which might lead one to one conclusion, while the reality of the market is something quite different. There are a lot of commonly articulated positions which have little basis in today's world. Examples abound.

1) On all sides, one can hear that there is a traditional, long standing legal separation of commerce from finance in America, but that is the shadow and not the reality. The debates about this unreal shadow world do not affect our daily lives. In the real world companies selling merchandise, building airplanes, drilling for oil in the North Seas, making cars and trucks--all clearly lines of commerce--own and are in the financial service business in a very big way.

The federal law in this respect is a one-way street--banks as institutions cannot engage in commerce, but commerce can engage in financial services. In the real world, however, banking and commerce have never been separate in American history. Since the eighteenth century banking and commerce have been united in law and in practice, directly or indirectly through affiliation on a personal or corporate basis. Whatever restrictions have been placed on banks as institutions, owners of banks have always engaged in all types of businesses.

Wells Fargo & Co. combined banking with the stagecoach business--indeed California law at that time practically required banking to be united with commercial firms. On a personal level, Joe Allbritton today owns control of and is CEO of Riggs National Bank, and he also owns five television stations. In New York City, a company chartered in 1799 to supply water to the City of New York, formed and owned the forerunner of Chase Manhattan Bank. The list is almost endless.

The further reality is that no one has ever articulated an agreed-upon definition of banking or of commerce. Indeed, the Supreme Court ruled that banking itself is commerce as recently as 1985.[1] On the other hand, so far as I know, there is no unique definition of commerce. It is hard to argue that it is injurious to the health of banks to own some company engaged in a line of commerce, but good for a maker of steel or automobiles to own a financial service business.

The reality is that most of us do not know who owns our friendly neighborhood lender, nor do we care as long as our needs are met. If GMAC offers the consumer 3.9% interest rate on a car loan, and our local commercial banker quotes 9%, the fact that General Motors is making the loan and not our local banker does not really enter into the consumer's decision.

2) Another issue of shadow and reality is the question of interstate banking. For years this issue has divided the industry and the politicians. It is no longer an issue even though one hears echoes of the old rhetoric in hotel ballrooms throughout the land. The facts are that the states have taken over and solved the problem, because Congress would not address the issue.

Of the 50 states in the Union, 44 and the District of Columbia currently offer some kind of reciprocal banking privileges to out-of-state American banks, ranging in terms from total freedom of entry today, to freedom of entry at some date certain in the future, to entry only with defined limited powers.

In the real world, then, the federal system of government worked, and the problem is all but solved by the

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[1] Northeast Bancorp, Inc. vs Board of Governors of the Federal Reserve System, 105 S. Ct. 2545, 2553-54 (1985)

action of individual states. In short, the 9th and 10th amendments to the Constitution are in full force and effect.

3) Another issue of shadow and reality is the so-called non-bank bank. As we have all learned by now, the non-bank bank is a non-issue issue. The institutions are performing a valid function in our economy and never did pose any threat to anything, except possibly some entrenched monopoly.

4) Another shadow issue is that the American market for financial services is separate from the rest of the world. The reality is that the American market, large as it is, is just one part of the global marketplace, and capital flows overwhelm trade. It is a matter of complete indifference to a major corporation whether it raises money, either debt or equity, in New York or London or Tokyo. All the corporate consumer wants is the best deal available in the marketplace. To think one can isolate U.S. financial institutions from the rest of the world is nostalgia, not reality.

5) The rhetoric is that one can get banking services only from banks. Reality is that Merrill Lynch offers checking accounts called CMAs, but the fiction is that only banks offer checking accounts. The reality is that Americans can get a credit card from commercial firms, get a mortgage from an automobile company, insure their life, house and car from a retailer, borrow money for their business from a maker of jet engines, buy stocks and bonds from a travel agency, and fulfill all their financial needs without ever going through a door with the sign "Bank" over it.

The companies offering consumers and businesses each of these financial services and many more, are listed in the phone books of America. In Middle America, in a representative city, Milwaukee, Wisconsin, the phone book lists over 50 places for its citizens to buy financial services and only 4 are major banks.

6) The idea that an American bank's monopoly position in cities or regions is protected by U.S. federal banking laws and regulation is also shadow and not reality. The Japanese are doing to American banking what they have done to American car manufacturers, but not for the same reason.

The Comptroller of the Currency reported in October last year that "The largest banking company in the world is Japanese. Four of the five largest banking companies in the world are Japanese. Seven of the 10--and 14 of the 25--largest banking concerns in the world are Japanese.

"Only six years ago, in 1980, none of the Japanese banks were among the largest five--and only one of the largest 10 was Japanese. The Japanese banks are not alone in global presence. Of the 10 largest banks in the world, two are French. Of the largest 25, nine are European."

7) The view from the Federal Reserve Board on products that can be offered by banks bears the same relationship to reality as does the federal ban on interstate banking. Once again, the federal system has operated and the states have taken over: currently five states allow state chartered banks to underwrite insurance beyond credit life, eight states sanction securities underwriting, eleven states favor equity investment, and twenty-two permit real estate development.[2]

The reality is that there is one-stop financial shopping at banks in some states, but not in others. Wisconsin banks can and do offer securities and insurance brokerage as well as banking services. There is also one-stop financial shopping in all fifty states at a Sears store or an American Express office.

8) Federal banking statutes now on the books were designed to protect the safety and soundness of the American banking system as it existed at the time they were passed. To a certain extent, the old statutes now contribute to the danger to the banking system. Anything that prevents the implementation of the first rule of sound banking, the wide diversification of risk, contributes a potential hazard to the system.

It follows from this, that if we are really interested in the stability of the banking system rather than preserving monopoly, we must find ways for banks to deliver new products to new customers in order to maintain a spread of risk in a business that is rapidly losing traditional products and customers.

Recently the Comptroller of the Currency, Mr. Clarke, stated the problem with great clarity: "Restrictions on allowable activities," he said, "have prevented U.S. Banks

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[2] American Banker, 6 May 1987, quoting a report by Victor L. Saulsbury of the FDIC.

from effectively serving changing customer needs, while other financial competitors have made significant inroads into some of the best banking market segments." He went on to say that "efforts should be directed at how to structure the new activities so as to allow flexibility and still protect the bank--not at delineating which activities should be permitted. I think we will find that there are few, if any, activities that cannot safely be combined with banking."

9) There is a myth that small town citizens are best served by small town enterprises which are locally owned. Today's reality is that these townspeople rely on Exxon, on Gulf or some international oil company for their gasoline and heating oil; they rely on some distant public utility for electricity to light their homes and barns; they rely on J.C. Penney and Sears for much of their shopping; they rely on A&P and other food chains for sustenance; they rely on some company like Citicorp or GMAC to supply mortgage money; they rely on AT&T long lines to talk to relatives in distant places.

This is not to say there are not local entrepreneurs--there are, including banks. Unfortunately for the myth of local banks taking care of local business, the facts are: In 1985 small banks had only 58% of their interest-earning assets in loans. The federal funds market was a big part of their business--selling local deposits to banks in big cities.

In fact, only 18% of the total assets of small manufacturers are supplied by bank loans.[3] It seems that more and more small businesses are reading ads like this one from Merrill Lynch which tell them: "If you could solve all your financial needs in one place, you could spend less time running from bankers to brokers to insurance agents and more time running your business. That's why Merrill Lynch offers business financial services. So that your local Merrill Lynch Financial Consultant can research your needs and provide innovative solutions."

In our pluralistic society, there is a place for all, but as in politics, where the voter decides, in business the consumer decides. Federal statues should be broadened to let American banks compete for the business.

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[3]See table appendix 1.

Appendix 1

How Manufacturing Firms
with Assets Under $5 million Are Financed

	1984	1985	1986
Debt ($ billions)	52.9	53.0	53.1
Bank Credit	21.7	21.5	21.9
Trade Credit	17.8	17.7	18.5
Other Short-term	1.8	1.9	1.7
Other Long-term	11.6	11.9	11.0
Equity ($ billions)	52.3	52.1	54.4
Total Assets ($ billions)	118.1	116.6	120.0
Share of total Assets funded by Bank credit (percent)	18.4%	18.4%	18.3%

Source: U.S. Commerce Department, Bureau of the Census, Quarterly Financial Report for Manufacturing, Mining and Trade Corporations, Fourth Quarter 1985 and 1986.