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A REVOLUTION IN BANKING

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ABSTRACT

Banking has played a very important part in the economic development of all the nations of the world. In fact banking is the life-blood of modern commerce. It may be said that the failure of banking system can completely paralyze the economic life of a nation. Thus a well-developed banking system is an indispensable necessity for modern trade and commerce.

Introduction and Brief History of Banking Industry

Before 1970 the banking system had evolved cartel like structure over seen by governmental and quasi-governmental regulatory agencies. It was characterized by a large amount of market segmentation. price fixing and entry restrictions.

(i) **Market Segmentation:**

Market segmentation existed to restrict competition and to encourage low cost home financing. The financial institutions were allowed to provide specific types of financial services and were prohibited to provide others i. e. commercial banks were allowed to accept deposits from households or business, upon which cheque could be written but the thrift institution (savings or mutual savings banks) credit unions were not allowed to accept deposits. They were allowed to accept only saving deposits upon which cheques could not be written.

Furthermore, thrift institutions were regulated in the following way. Adjustable mortgage payment schedules were prohibited until 1981 and ceilings were placed on the ratio of the size of the loan to the value of the house.

(ii) **Price Fixing:** The second important point of regulation period was fixed prices, or fixed interest rates. Commercial banks were not allowed to pay interest on checking account deposit. The interest rate was also fixed on saving in time deposits that could pay by thrift institution. The interest rate for thrift institutions was slightly higher the rate of commercial banks low than the rate of credit union could pay. Thrift institutions were given a competitive advantage over commercial banks in attracting savings deposits.

(iii) **Restricted Entry:** One of the conditions that result from regulating an industry was the creation of barriers to entry. Particularly during state and federal regulatory banking, agencies were required evidenced of " Need " for a new bank before they would issue a charter. Obviously the term " Need " was difficult to define objectively. Moreover, specific financial institutions were forced to operate under state laws.

In short, a governmentally regulated banking cartel had emerged with segment markets. price fixing and entry restrictions. Such arrangements worked reasonably well and fairly for a long time. The banking system was reasonably stable and financial institutions were rewarded with profit but market efficiency suffered as it often does when competition was disallowed. Banking services were over priced. The spread between the rate that depository institutions paid for deposit and the rate they charged certainly greater than it would have been under competitive system.

During 1970 particularly in America and later on in other countries, technological changes and changes in economic conditions revolutionized the banking industry and changed the form of money.