POLICY REPORT

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The Deregulation and Monetary Control Act of 1980

by Jeffrey Rogers Hummel

On 31 March President Carter signed into law the Depository Institutions Deregulation and Monetary Control Act of 1980, one of the most significant and sweeping pieces of legislation enacted during his administration. Rep. Henry S. Reuss (D-Wis.), chairman of the House Committee on Banking, Finance, and Urban Affairs and one of the chief sponsors of the bill, described the act as the most significant package of financial legislation since the 1930s, and Sen. William Proxmire (D-Wis.), chairman of the Senate Committee on Banking, Housing, and Urban Affairs and another of the bill's sponsors, declared the act the most important banking legislation since passage of the Federal Reserve Act.

Despite the act's momentous importance, however, it sailed quickly and quietly through Congress with almost no resistance just prior to the Easter recess. Solitary voices of opposition were raised in the House by Ron Paul (R) of Texas and in the Senate by William Armstrong (R) of Colorado. News coverage of the act has been almost nonexistent. Few publications have even bothered to mention the act's passage, and those that have done so have given the legislation little more than cursory treatment.

Background

To appreciate the substantial impact that the act will have, one must know a little about the existing structure for government control over money, banking, and credit. Commercial banks in the United States do business under three distinct tiers of government regulation. The first and oldest of these, the National Bank Act, is a legacy of the Civil War. It established a system of national banks chartered by the federal government and regulated by the Comptroller of the Currency. Second, in 1913 the Federal Reserve Act created a system of 12 regional Federal Reserve Banks coordinated by a seven-member Board of Governors appointed by the President. The Federal Reserve System (Fed) became the nation's central bank, with the power to control the size of the money stock. All national banks were required to become members of the Fed, and state chartered banks were given the option of doing so. The third tier emerged during the Great Depression with the creation of the Federal Deposit Insurance Corporation (FDIC), which insures the deposits of those commercial banks that comply with its regulations. All members of the Fed were compelled to get insurance from the FDIC, and nonmember banks could do so if they wished.

> **"In recent years, more and more banks have decided that life is less onerous outside the Fed . . ."**

The result of these successive waves of legislation has been to divide U.S. commercial banks into four categories: (1) national banks, which are regulated by all three agencies—the Comptroller of the Currency, the Fed, and the FDIC; (2) state banks that are members of the Fed and are therefore also regulated by the FDIC; (3) state banks that are not members of the Fed but are members of the FDIC; and (4) those state banks that belong neither to the Fed nor the FDIC. In addition, state banks must conform to their own state banking regulations, which adds to the regulatory confusion.

The Fed, in its conduct of monetary policy, has control over the first two categories of banks, but none over the second two. In recent years more and more banks have decided that life is a good deal less onerous outside the Fed, and as a result the Fed has been plagued with a large number of defections. Approximately 5,600 commercial banks are members of the Fed, but over 8,900 are not. Three hundred banks have withdrawn from the Fed in the last six years; over 150 left in the last two. Although the total assets of member banks—$860 billion—still exceed those of nonmembers—$300 billion—these defections nevertheless represent a steady erosion in the Fed's authority.

The growth of what economists call financial intermediaries (e.g., savings and loan associations) is another cause of the declining power of the Fed. Financial intermediaries, like banks, make investments with funds they acquire by issuing financial liabilities. Unlike commercial banks, however, the liabilities of financial intermediaries do not include demand deposits (checking accounts) and are therefore not traditionally considered part of the money stock. Thus while banks can

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Jeffrey Rogers Hummel is completing advanced work in economic history at the University of Texas at Austin.

EDITORIAL

Simplistic Solutions Reconsidered

That mass delusions can afflict entire civilizations is a well documented historical fact. In our own time there is no belief more widely held than the theory that the government can solve economic problems. Liberals and conservatives alike place the blame for economic ills squarely on Washington and loudly proclaim that economic well-being must, in some sense, either come from government or be coordinated by government. It is our contention that this view of government as problem solver is a mass delusion and nothing more.

The records established by governments all over the world as they have attempted to run their economies is unarguably dismal. Where the market becomes less free, regulations proliferate, "just prices" are decreed, and national economic plans are laid. The result is chaos, malinvestment, hyperinflations, and depression. Where generally desired results do take place, it is often not the government's policies that produce them but simple market mechanisms. Take, for example, energy conservation: As the price of energy rises, consumers will, other things being equal, buy less energy. This may take many forms, from simple conservation—turning out lights and turning down thermostats—to longer term solutions such as investing in more fuel-efficient automobiles. These responses to a price rise in energy can be predicted with confidence by economists of all political persuasions.

Yet when such a price rise actually occurred and the predicted cutbacks followed immediately, who took the credit? Not the free market, since that is merely a useful abstraction denoting the voluntary choices of millions of individuals and companies; the government took credit for energy conservation because it ran a national advertising campaign imploring people to use less energy. The campaign was, of course, completely superfluous and useless because the decline in energy consumption would have happened anyway.

Another of the responses to the energy "crisis" expected by economists is product substitution. Such substitution occurs when two similar goods can be interchanged profitably after price changes. Hence, we would expect the market to begin exploring synfuels, solar energy, wood stoves, and gasahol as the prices of oil and natural gas rise and product substitution takes effect. What is happening? The government, once again and with much fanfare, has passed legislation to subsidize the development of all the fuels and technologies that would have been developed anyway; hence, the government, and not the market, will take credit for the decline in oil use.

That few question this basic "government as Mr. Fixit" paradigm can be seen equally clearly in the debates over transportation safety. One side argues that the federally imposed 55 miles-per-hour speed limit is saving lives, in conjunction with all the government-mandated extra equipment on recently produced autos. The other side argues that higher oil prices are causing people to drive less and that newer roads and cars are safer. But few point out that, in fact, highway deaths per passenger mile have continuously declined throughout the century and that, all the government programs notwithstanding, they would have continued to decline anyway. The state, once again, takes credit where none is due.

During the recent presidential campaign, whenever any policy analyst or candidate referred to the market as a better problem solver than the government, political opponents and media pundits immediately denigrated such notions with epithets such as "voodoo economics" or "simplistic solutions." So enamored have we become of government programs, task forces, committee studies, regulatory agencies, congressional mandates, and presidential directives that we have turned reality on its head. It is *government programs* that are based on voodoo, i.e., on a foundation of mass delusion.

When the state "regulates, controls, constrains, or directs" the free market, it necessarily diminishes the freedoms of real people because abstractions such as the market do not act and do not have freedom. Both major political parties accuse each other of having poor economic policies, but in fact they are equally guilty because both offer American citizens nothing but more of the same tampering with the market through existing regulatory structures. The structures themselves are never questioned, only the results; and each party fights desperately to gain control of the overall apparatus. When the economy "does well" it is *in spite of government policies*, not because of them.

It is now time to "put away childish things." It is time to recognize, once and for all, that the government has no clothes. ■

Deregulation Act (Cont. from p. 1)

create money, financial intermediaries cannot. The validity of this distinction, however, has been challenged by economists who have argued that the money stock includes not only demand deposits but time deposits (savings accounts of all sorts) and many of the similar liabilities of financial intermediaries. And by seeking out ingenious ways to make the transfer of their liabilities easier, the financial intermediaries themselves have assisted in blurring the dividing line between financial intermediaries and commercial banks.

The debate among economists over precisely which financial liabilities should be included in the money stock will probably continue for some time. The Fed, as a result of this controversy, publishes several alternative money-stock totals. It is not necessary to resolve this question to recognize the importance of financial intermediaries to monetary policy. If one chooses to treat their liabilities as part of the money stock, then financial intermediaries, like banks, can create money. If one chooses not to view these liabilities as part of the money stock, they are nevertheless close substitutes for money that decrease the demand for money. Either way, whether financial intermediaries increase the supply of or decrease the demand for money, their effect on the economy is the same: The purchasing power of money falls and prices go up.

The term financial intermediary covers a wide variety of institutions, ranging from insurance companies to pension funds, but the financial intermediaries that most closely resemble commercial banks in their operations are of three types: mutual savings banks, savings and loan associations, and credit unions. There are about 500 mutual savings banks in the United States with assets totaling $160 billion. Many states do not grant charters to mutual savings banks, and they exist in only 18 states and are concentrated in the Northeast. Mutual savings banks can get federal charters, but only in states that grant them state charters. The Banking Act of 1933 offered mutual savings banks the opportunity to join the Fed, but very few of them have done so. Nearly two-thirds of mutual savings banks are insured, however, by the FDIC. Some mutual savings banks, including all those with federal charters, are members of the Federal Home Loan Bank System, which will be described below.

Savings and loan associations number about 4,700 and have assets totaling $520 billion, over three times that of mutual savings banks. Instead of issuing savings deposits that pay interest, as do mutual savings banks, savings and loan associations issue shares that pay dividends. Like mutual savings banks, savings and loan associations have made their investments primarily in mortgages.

Savings and loan associations were conspicuous enough to attract federal government regulation during the Hoover-Roosevelt New Deal. At that time, Congress established the Federal Home Loan Bank System, which regulates savings and loan associations in much the same way as the Fed regulates commercial banks. The system consists of 11 regional Federal Home Loan Banks coordinated by a three-member board appointed by the President. Just as the Fed sets the minimum amount of monetary reserves that must be held by member commercial banks, the Federal Home Loan Bank System sets the minimum amount of monetary reserves that must be held by member savings and loan associations. Just as the Fed loans money to its members at a discount, the Federal Home Loan Bank System loans money to its members through advances. The major difference between the Federal Home Loan Bank System and the Fed is that while Federal Home Loan Banks can create money only in the same way that commercial banks do—by expanding demand deposits—the Fed can create

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POLICY REPORT

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Deregulation Act (Cont. from p. 3)

high-powered money. High-powered money is the economists' term for the monetary base, which includes the currency in circulation and the reserves of commercial banks.

All federally chartered savings and loan associations and all federally chartered mutual savings banks must join the Federal Home Loan Bank System, while state chartered savings and loan associations and state chartered mutual savings banks may do so if they wish. Some insurance companies have also qualified for membership in the Federal Home Loan Bank System. Another New Deal agency, the Federal Savings and Loan Insurance Corporation, insures the shares of savings and loan associations. All federal savings and loan associations have their shares insured, while state chartered savings and loan associations, even if they are members of the Federal Home Loan Bank System, have the option of insuring or not.

Credit unions are the most numerous of the three types of financial intermediaries under consideration—there are almost 22,300 of them—but their total assets come to only $60 million. Although they have only recently been subjected to federal government regulation, they now have their own set of regulatory agencies analogous to the Fed. In 1970 Congress established the National Credit Union Administration, which regulates federally chartered credit unions. The National Credit Union Administration also insures the shares of all federal credit unions and those state chartered credit unions that qualify. In 1978 Congress added the National Credit Union Central Liquidity Facility, which grants loans to member credit unions.

Provisions of the Act

The Depository Institutions Deregulation and Monetary Control Act of 1980 came from an omnibus bill that combined many separate proposals, and consequently the act is a complicated hodgepodge affecting virtually every aspect of the federal government's control over money, banking, credit, and financial intermediaries. I have summarized the act by isolating 17 of its provisions, which in turn I have grouped in five general categories:

1. First, four provisions strengthen the power of the Fed: (1) The Fed is granted the power to regulate the reserves of *all* depository institutions, including nonmember banks, mutual savings banks, savings and loan associations, and credit unions; (2) the limits within which the Fed may vary reserve requirements are modified; (3) the Fed's discount window is opened to all depository institutions; (4) the Fed can now charge for such services as check clearing and can now offer these services to all depository institutions.

> **"The Fed is granted the power to regulate the reserves of *all* depository institutions . . ."**

2. Three provisions involve the freeing of interest rates from government restrictions: (1) The prohibition of interest for demand deposits and the limits on interest for time deposits will be phased out within six years; (2) state usury laws are overridden to varying degrees; (3) the ceiling on interest rates charged by federal credit unions is raised from 12% to 15%.

3. Two provisions lift restrictions on depository institutions: (1) Various restrictions on the services that different types of depository institutions can offer are eliminated; e.g., all depository institutions can offer Negotiable Orders of Withdrawal (NOW) accounts and savings and loan associations can offer credit cards; (2) various restrictions on the types of loans and investments that savings and loan associations, mutual savings banks, and credit unions can make are revoked.

4. Four provisions fall into the category of emergency provisions: (1) The Fed is given the power to set reserve requirements at any level, including zero, for a renewable period of 180 days; (2) the Comptroller of the Currency is empowered to declare bank holidays in any state or locality; (3) the level of insurance on accounts provided by the FDIC, the Federal Savings and Loan Insurance Corporation, and the National Credit Union Administration is raised from $40,000 to $100,000; (4) more kinds of collateral can now be used to back Federal Reserve notes.

5. Finally, the act contains four miscellaneous provisions: (1) The Federal Home Loan Banks and the National Credit Union Central Liquidity Facility can offer their members the same kind of check-clearing and settlement services that are provided by the Fed and at the same price; (2) various minor amendments to the National Bank Act are enacted; (3) the Truth in Lending Law is simplified; (4) a requirement for regulatory simplification is set down.

I will now describe each of these provisions in greater detail and attempt to analyze their impact.

Strengthening the Fed

(1) The Fed is granted the power to regulate the reserves of *all* depository institutions, including nonmember banks, mutual savings banks, savings and loan associations, and credit unions. In other words, the Fed has been granted control over all commercial banks, whether or not they have voluntarily joined the Fed, all mutual savings banks and all savings and loan associations, whether or not they have joined the Federal Home Loan Bank System, and all credit unions, whether or not they fall under the National Credit Union Administration. Foreign branches and subsidiaries of all these institutions are also included under the Fed's broadened authority. In order that this provision be enforced, all depository institutions must report regularly to the Fed, at the Fed's discretion.

This is the most important of the act's provisions, and its implications are obvious: At a single stroke Fed control has been expanded from 5,600 institutions with $860 billion in assets to nearly 40,000 institutions with $1,850 billion in assets.

(2) The limits within which the Fed may vary reserve requirements are modified. Previously the Fed could vary reserve requirements between 10% and 22% for demand deposits in reserve city banks, between 7% and 14% for demand deposits in other banks, and between 3% and 10% for time deposits in all member banks. The act, instead of employing the standard distinction between demand deposits and time deposits, distinguishes between transaction accounts and nonpersonal time deposits. Transaction accounts include demand deposits as well as various types of time deposits that permit the easy transfer of funds, such as NOW accounts, savings deposits subject to automatic transfers, and share draft accounts. The reserve requirement for transaction accounts is set at 3% for amounts under $25 million and can be varied by the Fed from 8% to 14% for amounts greater than $25 million. This $25 million dividing point is indexed so that it can increase or decrease beginning in 1982. The Fed can define the precise limits of what constitutes a transaction account, and it must apply a uniform reserve requirement for all transaction accounts at all depository institutions.

Nonpersonal time deposits are time deposits owned by businesses or corporations. The legal limits for nonpersonal time deposits are 0% to 9%, and the Fed can vary these rates according to the maturity of the deposit. Interestingly enough, this new classification scheme of transaction accounts and nonpersonal time deposits omits such personal time deposits as passbook savings accounts and individually-owned certificates of deposit, which no longer have any reserve requirements.

The act also empowers the Federal

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Trade Regulations/Department of Agriculture Watch

Agricultural Marketing Service regulations give each spearmint oil producer in the western United States an annual production allotment that should not be exceeded. Any producer who goes over his quota is forced to transfer his excess oil to another producer to enable that producer to fill a deficiency in his annual allotment.

On 11 March 1980, the Federal Grain Inspection Service published regulations and standards for the United States Grain Standards Act. A later review of these rules disclosed a number of typographical errors in the copy. A list of these errors covers three pages of fine print in the Federal Register.

The Department of Agriculture has handed down its final ruling on the quantity of California-Arizona lemons that may be shipped to the fresh market. Although this regulation creates higher lemon prices, the Agricultural Marketing Service claims that "such action is needed to provide for orderly marketing of fresh lemons. . . ." The same justification is offered for similar regulations on California and Arizona navel and valencia oranges.

The Department of Agriculture now prescribes legal procedures for the insuring of the processes of canning and freezing sweet corn. These regulations cover the availability of sweet corn insurance, premium rates, coverage levels, indemnities, and the methods for filing claims and obtaining policies. Other foodstuffs whose insurance is regulated by the USDA include wheat, barley, oats, and sugar beets.

A recent notice in the Federal Register estimates that the 1980–81 crop-year expenses of the Prune Administrative Committee are likely to exceed $200,000, or $1.26 per ton of prunes inspected. The purpose of the Prune Administrative Committee is to administer and enforce federal regulations covering California prunes.

The Secretary of Agriculture is exercising his power to extend price supports to cover domestic producers of 1980 crop sugar beets and sugar cane through either direct purchases or loans to would-be purchasers. No farmer of these crops will be permitted to sell them below the parity price, regardless of market conditions. The level of the price support, not yet determined, will be based on the producers' average costs of production.

Despite the Department of the Interior's call for stringent environmental impact statements for new construction projects, the Animal and Plant Health Inspection Service (USDA) has refused to provide such a statement for a proposed Biocontrol Laboratory at Mission, Texas. The Department of Agriculture simply stated that "there are no adverse environmental impacts anticipated in the future for this new facility." This statement has not been challenged by the Department of the Interior.

The Agricultural Stabilization and Conservation Service (another branch of the USDA) has issued a ruling concerning Maryland tobacco growers. Because these growers have refused to abide by national marketing quotas for the upcoming three-year period, they will be ineligible to participate in the tobacco price-support program. Only 17% of the Maryland farmers polled approved of the quotas, while 93% of Virginia farmers support them. For every pound of tobacco over 110% of their quota, Virginia tobacco farmers are fined $1.05.

Deregulation Act (Cont. from p. 5)

Reserve Board, on approval of at least five members, to impose a supplemental reserve requirement of 4% on the transaction accounts of every depository institution. These supplemental reserves, unlike regular reserves, will earn interest paid to the depository institutions by the Fed. Finally, an emergency provision that I describe more fully below allows the Fed to set reserve requirements on any depository liability at any level it desires, including zero, for a renewable period of 180 days.

In general, these new limits give the Fed greater discretion, although in some cases, as in the requirement that transaction accounts be uniform, the discretionary leeway of the Fed is reduced. In some cases the new limits will lower reserve requirements; in others, raise them. For instance, demand deposits now require fewer reserves, and passbook savings accounts require no reserves at all. On the other hand, NOW accounts, which were previously classified as time deposits but are now considered transaction accounts, will have their reserve requirements raised by the new rules. Furthermore, many institutions that were not previously subject to Fed reserve requirements will discover that they now need more reserves.

The new requirements went into effect on 1 September 1980. In addition, the act provides for a transition period of eight years for nonmember depository institutions and a transition period of four years for member banks. Depository institutions can hold required reserves in the form of vault cash or deposits at the Fed, and nonmembers can keep their reserves on deposit at corresponding institutions as long as the corresponding institution keeps an equal balance on deposit at the Fed. The reserve requirements apply uniformly to foreign branches of U.S. depository institutions, but deposits payable outside the United States are exempted. Depository institutions that are organized solely to do business with other depository institutions and are owned by those other institutions, such as the Federal Home Loan Banks, are also exempted from reserve requirements.

(3) The Fed's discount window is opened to all depository institutions. In other words, all depository institutions, and not just member banks, can borrow money created by the Fed. This is another step in eliminating the distinction between members and nonmembers of the Fed.

One of the minor provisions of the act that should be noted at this point is the elimination of the penalty discount rate. Previously the Fed was required to charge at least one-half percent more on loans to member banks that were secured by what was termed ineligible assets. The distinction between ineligible and eligible assets is a throwback to the days of the real bills doctrine, which taught that banks should create money only to cover short-term, self-liquidating loans.

(4) The Fed can now charge for such services as check clearing and can now offer these services to all depository institutions. Previously, the Fed provided such services as check clearing, settlement, and float to members for a zero price. Now the Fed must offer these services at a uniform fee to both members and nonmembers.

At first glance, this may appear to be a new source of profit for the Fed. The member banks, which legally own the Federal Reserve Banks, are restricted to no more than 6% dividends on their stock in the Federal Reserve Banks. If the new service fees do increase the revenue of the Fed—which is not at all certain—then the ultimate beneficiary will be the U.S. Treasury, which gets all Fed income that does not cover operating expenses and dividends.

The net effect of these provisions is to effectively eliminate the difference between members of the Fed and nonmembers. All depository institutions will be subject to the same reserve requirements, and all depository institutions will have access to the same benefits: the discount window, the check clearing, and other services. The only remaining difference between members and nonmembers will be that members will hold stock in the Federal Reserve Banks and nonmembers will not.

Advocates of the Depository Institutions Deregulation and Monetary Control Act have justified this expansion of power for the Fed as necessary in order to give the Fed more effective control over the money stock in its fight against inflation. Opponents of the act argue that these increased powers will not tighten control over the money stock but in fact ease the way for even greater monetary expansion and worse inflation. Both positions are wrong.

In order to explain why, let me briefly review the three major ways that the Fed can alter the money stock. (1) Open market operations: The Fed buys financial assets, such as government securities, with money that has been created just for that purpose. The Fed pumps money into the economy in exchange for financial assets or pulls money out of circulation when it sells those assets. (2) Discounting: The Fed loans newly created money to banks and other depository institutions. (3) Changing the reserve requirement: The Fed controls how much money the banks and now other depository institutions can create through demand deposits and other transaction accounts. When the Fed increases the required percentage of monetary reserves that the depository institutions must hold, the depository institutions must contract their demand deposits and other liabilities, thus decreasing the money stock. Lowering the reserve requirement has the opposite effect.

"The nullification of state usury laws is so hedged with qualifications as to be almost useless."

Of these three means of altering the money stock, changing the reserve requirement is both the most crude and the least effective. It is influenced not only by the behavior of the banks and other depository institutions, but also by the behavior of the public, which can change the size of bank reserves by withdrawing cash. On the other hand, just one of these tools, open market operations, is sufficient to give the Fed total control over the money stock. No matter what the depository institutions or the public do, the Fed can always counteract it by open market operations. If the depository institutions contract and reduce the money stock, the Fed can buy more assets and create more high-powered money. The expansionary potential of open market operations is nearly unlimited. If the depository institutions expand and increase the money stock, the Fed can sell assets and destroy money. Such a contraction is theoretically limited by how many assets the Fed owns, but since the depository institutions can expand only on top of the high-powered money base created by the Fed, this limitation is of no practical importance.

Consequently, giving the Fed greater power over reserve requirements is neither inflationary nor deflationary. Such power gives the Fed no more control over the total money stock than it already possesses. All that can be argued is that the act gives the Fed the ability to hit monetary targets with greater precision and speed, and even this alleged advantage owes more to the reporting requirements than to the reserve requirements.

The real significance of subordinating all depository institutions to the Fed lies not with the issue of inflation versus deflation but with the issue of liberty versus power. The exodus of banks from the Fed and the growth of financial intermediaries signify a shift in the banking and credit industry away from areas of government control and into areas of relative freedom. This shift demonstrates the market's capacity to survive and flourish in the interstices between regulations. The Depository Institutions Deregulation and Monetary Control Act is a reactionary countermove by the Fed to reassert its dominance and bring the entire banking and credit industry within its control. In order to achieve this goal, however, the Fed was forced to make some concessions to the market, and those are contained in the next two sets of provisions.

Freeing Interest Rates

(1) The prohibition of interest for demand deposits and the limits on in-

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GOVERNMENT SPENDING MONITOR

A quarterly feature of *Policy Report*, the "Government Spending Monitor" summarizes the latest expenditures by the federal government.

EXPENDITURES (annual rate in billions of $)

	1980 Third Quarter	1980 Second Quarter	1980 First Quarter	Average for Last Four Quarters
Federal Government	567.2	592.4	626.8	585.2
Defense	67.7	72	76.6	70
Labor Department	28.4	30	38.8	29.8
Education Department	*	13.8	13.2	13.5
Department of Health and Human Services	*	191.4	210.8	201.1
Housing and Urban Development	11.6	13.6	9.9	11.9
Department of Energy	4.9	7.6	8.3	6.5
Transportation Department	17.2	18	20.8	18.2
Federal Aid to State and Local Governments	86	86	86.4	85.7
Federal Interest Paid	64	89.2	67.2	75
Federal Transfer Payments	230	235.7	264.3	238
Federal Surplus or Deficit	−22.9	−49.2	−60	−44
Reported Federal Debt	855.3	875.3	894.3	865
Total Government Employment, All Levels (millions)	16.2	16.2	16.3	16.2

*Prior to May 1980, the Departments of Education and Health were one department with an annual outlay rate of 201.6 for the 1st quarter of 1980.

Sources: All data is derived from *Treasury Bulletin*, the *Monthly Treasury Statement of Receipts and Outlays of the United States Government*, and the National Bureau of Economic Research.

✓ Washington Update

✓ Perhaps the most encouraging referendum approved by voters in November was Massachusetts' property tax cap, popularly known as Proposition 2½ because it limits property taxes to 2½% of a given piece of property's assessed value. Massachusetts citizens, among the most severely taxed in the nation, approved the measure by a 60% majority. Other states passing tax relief measures include Arkansas, Missouri, and Montana.

✓ The minimum wage, which now stands at $3.10 an hour, is scheduled to go to $3.35 an hour on 1 January 1981. This will be the last scheduled increase in the minimum wage as voted by Congress in 1977. New proposals call for minimum wages of $3.70, $4.00, and even $5.00 over the next year or two.

✓ New Census Bureau figures show that the average American paid $934 last year in state and local taxes. This figure is $46 higher than the 1978 average and represents 12% of personal income. Alaska, New York, and Washington, D.C., had the highest state and local taxes, averaging $2,546, $1,370, and $1,336 respectively. Arkansas, Alabama, and Mississippi have the lowest taxes.

✓ A free telephone hot line set up by the federal government to encourage reports of fraud and abuse has already received 5,000 tips in the last two years. Over 1,000 of these calls have pointed a finger of guilt at the Department of Health and Human Services.

✓ The Federal Food and Drug Administration has proposed new regulations to encourage the production of caffeine-free cola beverages. One of the regulations makes the use of caffeine as an additive dependent on the food industry's funding of studies showing how caffeine affects children and human fetuses. The other regulation removes caffeine from the agency's list of safe substances but allows its use to continue, pending further studies.

✓ The Carter administration has reported a fiscal 1980 budget deficit of $59 billion, the second largest deficit in American history. This figure is twice the size of the projected $29 billion deficit that Carter originally reported in January. One Treasury official admitted that the release of this figure was delayed for several days until after the Carter-Reagan debate.

✓ The Senate has voted $12 million toward a research program for the automobile industry in order to spur America's "reindustrialization." The grant, an addition to an $11.8 billion appropriation for the Transportation Dept., is intended to finance long-term studies of new technologies that would enable American auto makers to compete more effectively with foreign cars.

✓ In 1980 the government spent approximately $51 billion on maintaining its day-to-day operations. This includes $33 billion for supplies and materials ranging from cleaning items to computers; $3.1 billion for travel; $4.9 billion for freight charges; $8.3 billion for rent and utilities; and $1.2 billion for printing and duplicating material.

✓ A recent study by the Congressional Budget Office has estimated that in 1979 the tax-free loans made available by the federal government cost American taxpayers $1 billion.

✓ The Treasury Department has proposed new regulations that would increase a lawyer's liabilities for writing legal opinions on illegal tax shelters. The Internal Revenue Service has labeled 25,000 tax shelters abusive in the last few years, and the Treasury Department has proposed the new regulations to combat the growing tax evasion problem. Lawyers would be allowed to discuss only shelters that were legal, even if they wished to advise against illegal shelters. Penalties would include disbarring lawyers who disobeyed the regulation.

✓ If a new IRS ruling is upheld, hundreds of authors will be denied the opportunity to see their books published and millions of books may have to be destroyed. The IRS contends that publishing houses have been improperly writing off their inventories by claiming sharply depreciated values for unsold books. Several Congressmen are planning to introduce bills to overturn the IRS ruling.

✓ President Carter has named the members of his Synthetic Fuels Corp., the group that Carter claims will "literally change the way we live." Deputy Energy Secretary John Sawhill, head of the corporation, announced the members: Frank Cary, chairman of IBM, Lane Kirkland, the president of the AFL–CIO, Cecil Andrus, Secretary of the Interior, Frank Savage of Equitable Life Insurance, Catherine Cleary of the First Wisconsin Trust Co., and John DeButts, former chairman of AT&T.

✓ A recent study of 74 federal agencies has tabulated 102,000 new publications in the last 18 months. The federal government's own estimate is 66,000 for the same period. One official remarked, "The government is putting out printed material faster than it can keep track of it."

✓ The Commerce Department has started a new program that will help selected businesses increase their exports to foreign nations. The program, dubbed "Strike Force One," will start with seminars on foreign trade for business executives, followed by trade missions and trade fairs. Herta Seidman, the assistant Secretary of Commerce, has stated that most of the participating firms will be in the $300–$400 million yearly gross range.

Deregulation Act (Cont. from p. 7)

terest for time deposits will be phased out within six years. This process will be supervised by a Depository Institutions Deregulation Committee, which centralizes the rate-fixing authority of all federal financial regulatory agencies and which will cease to exist when the six-year transition period is over. Any state restrictions on the amount of interest that can be paid on deposits or accounts are also eliminated. The six-year delay is a concession to the savings and loan associations. Although the interest paid by commercial banks has been regulated by the Fed since 1933, the interest that savings and loan associations could pay was not controlled until 1966. In that year the Federal Home Loan Bank Board was granted the authority to limit the rates paid by savings and loan associations. The board has always set these limits slightly higher than the limits for commercial banks. Furthermore, savings and loan associations have more of their investments tied up in long-term mortgages at low interest rates than banks do. The delay will help them adjust more smoothly to new competition from commercial banks.

(2) State usury laws are overridden to varying degrees. State usury laws for mortgage loans are permanently overridden, unless a state explicitly rescinds the override within three years. State usury laws for business and agricultural loans in excess of $25,000 are overridden, but only for three years and only up to five percentage points over the Fed discount rate. The states can also explicitly rescind this override. All federally insured state banks, federally insured mutual savings banks, federally insured savings and loan associations, federally insured credit unions, and small business investment companies are exempted from state usury laws up to one percentage point over the Fed discount rate. This extends to all federally insured depository institutions an exemption that national banks have enjoyed since 1933. The states cannot rescind this exemption.

Many of these provisions have already been enacted in past stopgap legislation. Because of doubts about the constitutionality of overriding state usury laws, the authors of the Deregulation Act added a severability clause that allows one provision relating to state usury laws to be declared invalid without affecting the other provisions.

> **"If Congress were really interested in regulatory simplification, it would not have passed this act but abolished the regulatory agencies instead."**

(3) The ceiling on interest rates charged by federal credit unions is raised from 12% to 15%. The National Credit Union Administration can raise this ceiling even higher for periods up to 18 months after consultation with the Department of the Treasury, appropriate committees of Congress, and the other financial regulatory agencies.

All of these provisions are moving in the right direction, but none of them goes far or fast enough. Depositors and savers are forced to wait for six years for the elimination of restrictions on interest on deposits. The nullification of state usury laws is so hedged with qualifications as to be almost useless. Fortunately, the legalization of NOW accounts, which will be discussed below, in effect eliminates the prohibition on interest for demand deposits held by individuals. Particular notice should be taken of those provisions that tie the usury law override to the Fed discount rate. In periods of high inflation and high interest rates, when almost all state usury ceilings will be exceeded by the market, this converts the discount rate from an instrument for monetary control into an instrument for interest rate control.

Lifting Restrictions on Depository Institutions

(1) Various restrictions on the services that different types of depository institutions can offer are eliminated. Negotiable Orders of Withdrawal (NOW) accounts are checking accounts that pay interest, and they have been available from commercial banks in New England since 1974. The act permits all depository institutions in the nation to offer NOW accounts beginning on 31 December 1980. Automatic transfer accounts, which have been permitted in the past under stopgap legislation, can now be offered by federally insured commercial banks. Remote service units at federally insured savings and loan associations, which have also been permitted in the past under stopgap legislation, are now permanently authorized. In addition, federal savings and loan associations have gained the right to offer credit card services, to exercise trust and fiduciary power, and to issue mutual capital certificates. Federal mutual savings banks can accept demand deposits from any source. Federally insured credit unions can now offer share draft accounts.

(2) Various restrictions on the types of loans and investments that savings and loan associations, mutual savings banks, and credit unions can make are revoked. Federally chartered savings and loan associations can now invest in open-end investment companies, and their ability to make real estate loans and acquisition, development, and construction loans is expanded. They can also now invest up to 20% of their assets in consumer loans, commercial paper, and corporate debt securities, all areas that were previously reserved for commercial banks. Federally chartered mutual savings banks can now invest up to 5% of their assets in commercial, corporate, and business loans, provided such loans are within the same state as the mutual savings bank and within 75 miles of the bank's home office. Federal credit unions can now make loans on individual cooperative housing.

All of these provisions are substantial concessions by the government toward freeing depository institutions from regulation. As noted above, the nationwide legalization of NOW accounts makes irrelevant for individual depositors the prohibition of interest on demand deposits. By allowing credit unions, mutual savings banks, and particularly savings and loan associations to both offer services and make investments that were previously the exclusive domain of commercial banks, the act further contributes to blurring the distinction between commercial banks and financial intermediaries.

Emergency Provisions

(1) The Fed is given the power to set reserve requirements at any level, including zero, for a renewable period of 180 days. This power can be exercised only with the consent of five out of the seven members of the Federal Reserve Board, and the board must promptly report the reasons for its action to Congress. The power furthermore extends to *all* liabilities of depository institutions and not simply to those with existing legal reserve requirements. The most likely use of this power will be to lower reserve requirements below the statutory floor during periods of financial stringency.

(2) The Comptroller of the Currency is empowered to declare bank holidays in any state or locality. This power extends to the closing of national banks only, not state banks, but otherwise it is unrestricted. The act requires that it be used "in the event of natural calamity, riot, insurrection, war, or other emergency conditions occurring in any State whether caused by acts of nature or man. . . ."

(3) The level of insurance on accounts provided by the FDIC, the Federal Savings and Loan Insurance Corporation, and the National Credit Union Administration is raised from \$40,000 to \$100,000. This increase is designed to enhance public confidence in the financial system, and it was heavily lobbied for by savings and loan associations. Opponents argue that the increase greatly overextends the resources of the FDIC and other insuring bodies. This criticism, however, ignores the fact that *no* insurance reserves will be sufficient if all insured disasters happen simultaneously. If all commercial banks failed at once, the FDIC would not be able to pay, just as a fire insurance company would not be able to pay if all the homes it insured burned down at once. Whether the limit is \$40,000 or \$100,000, federal insurance could never cover the losses from a massive bank and financial failure without the injection of huge quantities of new money.

> **"The net effect of all these provisions is to effectively eliminate the difference between members of the Fed and nonmembers."**

(4) More kinds of collateral can now be used to back Federal Reserve notes. Any asset purchased by the Fed may now be collateral for Federal Reserve notes in circulation, and Federal Reserve notes in the vaults of the Fed no longer require any collateral. To appreciate the importance of this point, remember that the Fed issues high-powered money in two forms: Federal Reserve notes and deposits at Federal Reserve Banks. These two are interchangeable and the difference between them is of no economic significance, except that only banks and other depository institutions can hold deposits at the Fed. To create either notes or deposits, the Fed must acquire some kind of asset, either through open market operations or through the discount window.

Prior to 1968 the Fed was required to back 25% of the Federal Reserve notes outstanding with gold assets. This restriction did not directly limit the amount of high-powered money the Fed could create, but only what form it could take. Because the amount of high-powered money in deposit form, however, is limited by both the willingness of commercial banks to hold deposits and the public's desire for currency, the gold restriction in practice limited the Fed's ability to expand high-powered money.

When the gold restriction was repealed in 1968, a second restriction that had been on the books remained: The Fed had to hold, in the form of gold or eligible paper, assets that equaled or exceeded the total amount of Federal Reserve notes in circulation and in Fed vaults. Again, this restriction did not directly limit the money-creating power of the Fed but only the form that such money could take. Unlike the 25% gold restriction, however, this requirement has never been operative because the amount of eligible paper held by the Fed has always been the major portion of the Fed's assets.

The only circumstance under which this collateral requirement would limit the Fed would be if the Fed tried to bail out a collapsing banking system with massive infusions of Federal Reserve notes. For this reason I have categorized the broadening of the collateral restriction as an emergency provision. Now that any Fed asset can be used as collateral, the Fed can, if necessary, convert *all* high-powered money into the form of Federal Reserve notes. Consequently, the ability of the Fed to compensate for a contracting banking system by creating money is unimpeded.

These emergency powers are interesting less for what they allow the government to do than for what they reveal about government expectations and intentions. All of them, with the possible exception of raising insurance coverage, are powers that in any genuine financial emergency the government would have exercised anyway—with or without legal authorization. Hard-money advocates who forecast economic doom are split over whether their projected economic catastrophes are inflationary or deflationary. The emergency provisions of this act should forever silence the forecasters of deflation. These provisions make clear the intention of the Fed and other monetary authorities to keep the money stock expanding, even in the unlikely event of a widespread financial panic that makes it necessary for the Fed to flood the economy with high-powered money.

Miscellaneous Provisions

(1) The Federal Home Loan Banks and the National Credit Union Central Liquidity Facility can offer their members the same kind of check-clearing and settlement services that are provided by the Fed and at the same price. This provision was a consequence of allowing mutual savings banks, savings and loan associations, and credit unions to offer NOW accounts, but it is also somewhat superfluous because nonmember depository institutions can now also get the same services from the Fed itself. This provision also brings the Federal Home Loan Bank System and the National Credit Union Administration another step closer to being Fed analogues.

(2) A variety of minor amendments to the National Bank Act are enacted. For instance, the Comptroller of the Currency can now grant a national bank an additional five years on top of the five years already allowed to divest itself of any real estate it acquires as payment or settlement for a loan. Bank holding companies are prohibited until 1 October 1981 from interstate acquisition of trust companies unless such an acquisition is explicitly permitted by the state in which the trust company resides. One of the amendments provides for the final liquidation of funds in possession of the Comptroller from banks that went into receivership before 1934. Although not technically an amendment to the National Bank Act, one provision that fits in here and fills an entire title in the act placed a moratorium until 1 July 1980 on the foreign acquisition of controlling interest in any U.S. depository institution. Some of these amendments marginally decrease the burden of federal regulation on national banks; some of them marginally increase it.

> **"Ironically, the one area in which the act gives the Fed no additional power is control over the money stock, which was the act's stated goal . . ."**

(3) The Truth in Lending Law is simplified. Indeed, the Truth in Lending Law simplification takes up one of the longest of the act's nine titles. In general, the simplification reduces the number and detail of the Truth in Lending disclosures required by law. Agricultural credit is exempted from Truth in Lending requirements. In short, the simplification grants a marginal decrease in regulation.

(4) A requirement for regulatory simplification is set down. This requirement is absurd. I mention it only because it fills another, albeit shorter, of the act's nine titles. It consists of instructions to the financial regulatory agencies not to impose regulations on depository institutions that are too costly, that duplicate one another, that are inconsistent, that are unclear, that are not as simple as possible, etc. If Congress were really interested in regulatory simplification, it would not have passed this act but abolished the regulatory agencies instead.

Conclusion

The impact of the Deregulation Act of 1980 on liberty is ambiguous. Although some of its provisions increase government power, other provisions reduce government power. On the whole, however, the act must be considered a blow against liberty.

The act's central feature is the subordination of all depository institutions to the authority of the Fed. Prior to the act's passage, the number of banks defecting from the Fed was on the rise, while the importance of financial intermediaries, which were outside the Fed's domain, was growing. These developments reflected the resilience of the market even in an industry that has been traditionally dominated by government. Unfortunately, the act reverses both of these healthy trends. It does not force any depository institution to join the Fed, but it leaves only a nominal difference between members and nonmembers, so that in essence all depository institutions are Fed members.

In light of the increased power given the Fed, the act's concessions to the market appear negligible. They were made only to facilitate the Fed's assumption of greater authority. The deregulation of interest rates is either drawn out over six years or hedged with qualifications. The greater freedom for banks and financial intermediaries to offer more services and to make previously proscribed investments, while a genuine gain, is merely the means by which the Fed buys the submission of its new charges.

Ironically, the one area in which the act gives the Fed no additional power is control over the money stock, which was the act's stated goal and the justification for all the other new powers granted the Fed. The Fed's ability to determine the size of the money stock is neither increased nor reduced by the act. Only in the Fed's ability to respond to a severe financial crisis does the act make any difference. In short, the Depository Institutions Deregulation and Monetary Control Act of 1980 is yet another violation of freedom being falsely sold as a means to fight inflation.

"To be governed..."

CPSC: just another agency under fire

Somebody out there doesn't seem to care much for the Consumer Product Safety Commission.

At least that's what it seems like to the employees at the agency's Bethesda headquarters.

Four times in the last month arsonists have set small fires in the high-rise office building that houses the agency. And then this week on election day an anonymous caller made a bomb threat that forced all 500 employees to evacuate.

John Bell, a spokesman for the agency, said the commission has asked the FBI to investigate the incidents.

The FBI, Bell said, told the commission that such incidents were "very common among federal agencies" and if they investigated the problems at the CPSC they would have to do the same for everyone else.

—*Washington Post*, Nov. 7, 1980

Tweedledum and Tweedledee

Political image makers squirmed over polls indicating that, despite 30 million dollars spent for television advertising, voters wound up with pretty much the same impressions of Carter and Reagan that they held at the start of the campaign.

—*U.S. News & World Report*, Nov. 10, 1980

The paper chase—part I

A North Carolina hospital needed federal approval to replace two X-ray machines. It took more than 160 staff hours to finish the required paper work, which weighed in at some 47 pounds of documents.

—*U.S. News & World Report*, Sept. 22, 1980

The paper chase—part II

Officials of a major rubber company complain that complying with a single new order of the Occupational Safety and Health Administration required the firm to process in one week more than 345,000 sheets of paper weighing 3,200 pounds and taking more than 2,000 man-hours.

—*U.S. News & World Report*, Oct. 20, 1980

Nothing but the best for DOE

Hiring consultants can be a costly way of conducting the government's business. An internal Department of Energy report notes that last year some of the agency's top consultants drew annual salaries of $75,000 and $92,700. The head of the agency drew "only" $66,000 and his top aides were paid $47,500.

—*Washington Post*, Sept. 17, 1980

Two studies are better than one

Four Federal repositories can be used to locate a substantial portion of the studies performed by Government employees and consulting services. GAO has found that agencies are not searching these repositories before initiating new studies, and many completed studies are not submitted to the repositories.

—*They're Your Taxes*, Northern New Jersey Chamber of Commerce and Industry, July 1980

Be prepared

The nation's missile warning system is so delicate it produced 147 false indications of a Soviet missile attack on the United States during the last 18 months, a Senate report said yesterday.

—*Washington Post*, Oct. 29, 1980

But why am I still unemployed?

The recession ended in late summer, making it the shortest one on record. If it had been any shorter, the game warden would have made us throw it back.

Autumn had scarcely begun when we knew the upturn had commenced. We have the giant computer to thank for this promptness in knowledge.

—Paul Samuelson, *Newsweek*, Nov. 3, 1980

A job well done

Forty-nine of the government's top career people got a $20,000 pat on the back the other day from the President. He did it by giving them the title "distinguished executive" which, along with the honor of the thing carries the larger first-time awards. Another 206 executives got $10,000 awards.

—*Washington Post*, Sept. 20, 1980

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