

POLICY REPORT

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Harvesting Washington

by Tom Hazlett

Listening to a public debate on U.S. agricultural policies is like being set adrift in a sea of clichés: "We must protect the family farm," "we must preserve our vital agricultural interests," and "we must maintain an orderly flow of goods to market" are among the hoary platitudes that swirl around you. Equally disheartening is the assumption underlying these clichés: Without the intervention of the federal government, no one could earn his livelihood farming.

That policies called for by interests as red-blooded and patriotic as the American Farm Bureau would be dubbed socialism in another time or place is no less ironic than the near-mystical reverence with which the average American regards those who farm. This attitude toward the tillers of the land is responsible for far more than a renewed popularity in denim fashions and the early films of Henry Fonda. It has led to nothing less than the establishment of a multibillion dollar subsidy clearinghouse, otherwise known as the United States Department of Agriculture.

The USDA has an incredibly complex maze of programs under its wing: loans, target prices, deficiency payments, trigger prices, import quotas, tariffs, set-asides, parity pricing, flow-to-market restrictions, insurance programs, inspection services, grade and quality standards, allotments—just to name a baker's dozen. The department's organization chart outlining the bureaucracy necessary to administer these services might well be entered as a piece of impressionistic sketch-line art. Yet, despite the complication of it all, each particular policy seems to have a

Tom Hazlett, a doctoral student in economics at UCLA, is a staff member of the International Institute for Economic Research.

remarkably similar effect: increasing the farmer's net income.

In a competitive economic environment, farmers would be expected to increase their wealth at the same time and by

"From Nixon's milk money scandal to Reagan's sugar lobby purchase order, farm subsidies smack of the worst in backroom 'democracy.'"

the same process that non-farmers are increasing *their* real incomes by producing goods of increased quality and quantity (and hence lower effective prices). Still, and not surprisingly, the Department of Agriculture was not instituted to conduct seminars on the dynamics of market competition, gains from trade, or the advances made possible by voluntary specialization in areas of comparative efficiencies.

Agricultural policy, despite the often disingenuous claims heard in public forums, has been fashioned—directly or indirectly—to contravene the marketplace for food. The impetus for virtually all current U.S. agricultural programs, moreover, was the Great Depression. With the Agricultural Adjustment Act (1933), the Agricultural Marketing Agreement Act (1937), and other major legislative changes of the New Deal, the federal government lent its active cooperation to a farm lobby-USDA open conspiracy to keep food prices *up*.

The farmers' plight during the 1930s generates, even today, great sympathy

because that decade saw a substantial deflation. Caught between their mortgage payments—due and payable in pre-deflation dollars—and falling commodity prices—reflecting the *increased* value of each nominal dollar—thousands of farm owners were threatened with bankruptcy and foreclosure.

In an open and frank manner, agricultural interests promoted major farm legislation to raise food prices and thereby penalize consumers in order to save the farmers. Unlike the National Recovery Act (NRA), which had attempted such a price-fixing policy for business interests, the agricultural bills were *not* declared in violation of the Constitution and continue (in frequently amended form) to provide the basis of Washington's farm policy.

Navel orange marketing orders in the California-Arizona market may be used to illustrate a small part of the regulative maze. A group called the Navel Orange Administrative Committee is empowered by the USDA to meet weekly during the orange season (basically November to June) and set quotas on the quantity of oranges that may be handled by each packing house (and hence sold by each grower). These quotas cover only the fresh fruit market, leaving the farmers free to sell to the concentrated juice or cattle-feed markets. Additionally, they do not set any *total* limit on a farmer's seasonal production but regulate only his *weekly* sales during the high-volume months. The farmer can sell all he wants when there are no oranges on the trees.

The justification for these marketing orders, as they are called, is that they regulate an "orderly flow to market," protecting both farmers and consumers from wildly erratic price swings as the crop is

(Cont. on p. 3)

Privatize Air Traffic Control

The air traffic controllers' strike is just another example of the breakdown of big government, albeit one that will have particularly serious consequences for users of the nation's airways. If OSHA agents went out on strike and President Reagan fired them, we'd all be better off. But an aviation system needs air traffic controllers.

One thing the strike clearly illustrates is how much more severe public sector strikes are than strikes by private sector workers. Because the air traffic control system is a monopoly, travelers cannot patronize a company whose workers are not striking. They are forced to suffer because of the government's monopoly over this service.

In addition, private companies have some degree of control over unions because they have to make a profit; inordinately excessive union demands may lead to bankruptcy for the company, and the union's awareness of this possibility holds their demands in check. We saw this recently in the case of the *Philadelphia Bulletin*, where management threatened to close the paper unless concessions from the union were forthcoming. In the wake of the *Washington Star's* demise, this threat was quite convincing, and the union was willing to bargain.

But governments can't go bankrupt; they just raise taxes or print more money. Businessmen face the test of the market; politicians face only the next election. Thus politicians have an incentive to give in to union demands. Failure to do so will generate hostility from a well-organized bloc of voters and possibly the general public if services are disrupted.

The impact of unions on government services and ultimately on the citizens who are forced to depend on those services is just another reason to transfer such services to the private sector. But how can we transfer air traffic control to private industry? Isn't air traffic something that has to be run by the government?

Not at all. Indeed, the recent record of the Federal Aviation Administration makes the FAA a prime candidate for dismantling. In 1962 the FAA announced a 10-year plan to automate the air traffic control system, but its plans—obsolete from the beginning—were a failure. In 1970 the editor of *Aviation Week*, Robert Hotz, accused the FAA of "technical incompetence and slothful leadership." The House Subcommittee on Government Activities pronounced the plan a failure.

In the 1970s the FAA tried again with its Radar Data Processing system—the one the controllers are complaining about today. A Senate study last fall concluded that

management of the air traffic control system was so poor that the FAA had no way of knowing how long its present computer capacity would be adequate.

Air traffic control is too important to be left in the hands of a politically run bureaucracy. The safety of Americans demands a better system.

The Special Air Safety Advisory Group—six retired airline pilots appointed by the FAA in 1975 after a major crash that was blamed on FAA mistakes—suggested that the air traffic control system be operated as an independent public company along the lines of Comsat. A similar plan was endorsed in 1969 by the Professional Air Traffic Controllers Organization.

But such a public company would still be a monopoly, still be subject to political pressures and largely immune from the discipline of the market. Why not move to a strictly private system, either a profit-making company or perhaps a nonprofit corporation jointly owned by the airlines? There's ample precedent.

Aeronautical Radio Inc. (Arinc), a nonprofit corporation jointly owned by the airlines, was set up in 1929 to provide radio communications and navigation services between air and ground. Arinc set up the first air traffic control centers before the federal government preempted the field. After that, Arinc pioneered the development of airborne very high frequency radio, navigational beacons, and instrument landing systems. Today Arinc operates for the airlines the world's largest private-line intercity communications network and the computer system that links more than 40 airline reservations systems. Arinc's specifications for aviation electronics equipment are accepted worldwide. Arinc or a similar company could handle air traffic control.

In several foreign countries air traffic control is a private enterprise. Flights to Switzerland are under the control of Radio Suisse, a nonprofit corporation financed by user charges. Mexico's Radio Aeronautica de Mexico, S. A. (Ramsa), a joint air traffic control project of Mexican airlines, was privately operated until its nationalization in 1978. International Aeradio Ltd. provides user-financed air traffic control services in many parts of the former British Empire.

There's ample precedent for privately operated air traffic control systems. Such a system would operate more efficiently and keep pace with technology. Its rates and wages would be set by market forces, not by political pressures. It would provide American travelers with safe, efficient, technologically advanced services at a fair price.

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harvested. Fresh fruit cannot be stored for any substantial length of time, and an unregulated market would lead to a chaotic succession of gluts and scarcities. If oranges are pushed into the concentrate and cattle-feed markets, a stable price can be maintained without any waste.

All of these arguments have come under increasing attack recently, even from farmers themselves. This is somewhat ironic, in that the marketing orders of the NOAC are set by growers (who dominate the committee) for growers. The arrangement is such an obvious breach of the Sherman Antitrust Act that an act of Congress (the Capper-Volstead Act of 1922) was needed to provide a shield against federal prosecution. Still, analysts at both the Justice Department and the Federal Trade Commission remain concerned about the monopolistic elements of such agreements. (However, in the last session of Congress, agricultural interests successfully introduced legislation prohibiting the FTC from prosecuting, analyzing, or studying such marketing orders.)

To outside observers, the agreement to restrict output in the prime (fresh fruit) market during the peak season is no more than a "conspiracy in restraint of trade." And even the USDA itself in 1975 concluded a study with the finding that such agreements raise prices to consumers. Although no oranges are "physically wasted" by diversion to use as cattle feed, they are economically wasted in that consumers are willing to pay several times the price for fresh oranges that they are for "cattle feed" oranges. Yet only 57% of the 1980-81 crop was permitted to be sold directly to consumers. No argument that this restriction helped to protect consumers from a "glut" is worthy of consideration; if consumers wanted fruit to be directed to other places, times, or markets, it would have been profitable for retailers or wholesalers to stock, store, or ship those oranges. (The reason, incidentally, that oranges are not kept on the tree for sale year-round is that their flavor tends to diminish if too much ripening takes place. Marketing orders, which spread out the orange season by restrict-

ing the flow-to-market by weekly allotments, must therefore work to give the consumer less flavor than he desires; otherwise it would be profitable to withhold fruit without the regulations.)

What remains interesting is that this legally sanctioned output-restricting textbook cartel is facing powerful challenges from within its ranks. Independent orange growers are questioning the authority of the USDA to limit their sales. The problem seems to be that, despite the price-raising effects of the orange marketing orders, some growers would be better off producing more oranges at lower prices. These must be the more efficient orange producers, for they are willing to risk diminished prices in exchange for a chance to increase their market. They are arguing, basically, for an end to the monopoly mechanism that depends on curtailing supply to enhance profits. At recent USDA hearings on the orange marketing orders held in Exeter, California, many independent growers, and all consumers' representatives, testified in favor of abolishing output quotas. Sunkist, the giant orange cooperative representing better than half the California-Arizona orange industry, led the fight to retain the marketing orders.

Despite its free-market rhetoric, the Reagan administration has given almost no indication that it will attack the subsidies, output controls, and import restrictions that distort consumer preferences to the benefit of special interests. In its first months, the new administration has even moved to increase import restrictions on sugar as a political payoff to some key Southern congressmen.

Two major findings emerge from an examination of government subsidies to agriculture. The first is that there is a widely held belief (held even by most consumers) that for "special" reasons farmers cannot be left to the anarchy of the marketplace. Fluctuating prices, seasonal crops, the vagaries of the weather, the constraints of the plant and harvest cycles, the perishability of commodities—all are alleged to exempt the farmer from ever possibly participating in the

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ideal of market competition. That futures markets, or private insurance, or co-ops, or vertical integration would automatically arise (along with numerous other institutions) to provide those services demanded by farmers and consumers seems an incredible proposition to those blinded to the thousands of ways precisely these remedies have spontaneously arisen to solve similar "special" circumstances.

The second finding is that the political handout is by nature nonreciprocal. Conditions will inevitably change (falling commodity prices is definitely not a prob-

lem for the 1980s), but yesterday's political solutions remain intact. As one recent book on agricultural policy noted with respect to a particularly costly and counterproductive regulative scheme called the Agriculture Conservation Program (ACP), "... the last six presidents of the United States, despite wide divergence in the style and substance of their administrations, have all proposed that it be eliminated." The democratic result? "But the ACP has had sufficiently well-placed friends on the congressional appropriations committees to survive all challenges to date. In 1978,

\$240 million in payments were made to farmers under the program."

The lesson that "special" circumstances that require "special" measures can lead to a stranglehold on the powers of state by the special interests thus patronized is a lesson characteristic of the political process both on and off the farm. From Nixon's milk-money scandal to Reagan's sugar-lobby purchase order, farm subsidies smack of the worst in backroom "democracy." Whatever its other features, the politics of agriculture is anything but special. ■

Free-Trade Zone International Banking Facilities: A New Option for U.S.-Based Banks

by Eugenie Dudding Short

The Federal Reserve Board recently altered its position on free-trade zone International Banking Facilities (IBFs) and ruled that effective 3 December 1981 U.S. banks will be permitted to establish IBFs in the United States.¹ New York-based banks, in particular, have been actively campaigning for the establishment of these facilities since the summer of 1977. One year later, in July 1978, the New York Clearing House Association² submitted a formal request to the Fed aimed at obtaining permission to establish IBFs in the United States. After a delay of three additional years, the Fed finally reached the decision to revise its regulations affecting international banking transactions in order to enable U.S.-based banks to open IBFs in this country. Part of this delay reflects former Fed Chairman G. William Miller's opposition to the proposal. In addition, both the Chicago-based banks and several of the regional banks opposed the free-trade zone facilities, arguing that they would give the New York City money-center banks an "unfair" competitive advantage. Despite this less-than-unanimous support of the IBFs by U.S. banks, together

Eugenie Dudding Short is a senior economist in the Money and Banking Section of the Federal Reserve Bank of Dallas.

with concerns by Fed officials about the monetary policy implications of these **"U.S. banks conduct a large portion of their international banking transactions through offshore branches to avoid certain Federal Reserve regulations."**

facilities, the Board did finally rule in favor of the New York-originated proposal. An examination of the issues raised in reaching this decision provides some interesting insights into both the manner in which U.S. banks conduct banking transactions in today's globally linked financial markets and the manner in which the Fed attempts to conduct domestic monetary policy given this increasingly integrated international monetary framework.

It is well known that U.S. banks conduct a large portion of their international banking transactions through offshore branches to avoid certain Federal Reserve regulations, namely reserve requirements

and interest-rate restrictions. It is also well known that offshore branches are frequently located in tax havens to avoid state and local taxes. For U.S. banks, the Caribbean area provides the most convenient offshore location for conducting international financial transactions because, in addition to having no income tax, the Bahamas and the Cayman Islands are also in the same time zone as New York. This coincidence of working (trading) hours has given the Caribbean area a competitive edge over other financial centers in attracting business from U.S.-based institutions. Since the new IBFs will primarily serve as substitutes for these offshore Caribbean facilities, a brief overview of how banks currently conduct their international banking transactions via these offshore centers will provide important insights into the impact that the new, domestically-located IBF facilities are expected to have on domestic banking operations.

Shell Branches

A key factor that differentiates Caribbean branches from other foreign branches of U.S. banks is that almost all of these branches are "shell" branches staffed at a U.S.-located banking office. Hence the offshore Caribbean shell branches are, in most

instances, used only as booking centers for U.S. banks. The banking transactions booked at these centers are actually conducted at a domestic banking location. For accounting purposes, and to ensure the legality of the transaction, eligible international transactions are placed on the books of the U.S. bank's Caribbean office.³ The term "eligible international transactions" must be underscored because the business conducted through these offshore branches is monitored by various regulatory agencies. And, although it is both difficult and costly (not to mention of questionable value) for either the commercial banks or regulators to determine what does constitute an "eligible international transaction," the regulators do remind U.S. banks that the business deposits and loans booked at these facilities should be used to support business operations outside the United States, and the individual deposits and loans must be to non-U.S. residents. Simply stated, this means that U.S. banking customers without international business connections are not eligible to earn the frequently more attractive Eurodollar rates on their deposits.⁴

Federal Reserve officials are aware of the difficulty in monitoring bank transactions to determine whether or not non-eligible transactions are being conducted. Moreover, it is commonly recognized that Eurodollar "leakages" from both eligible and non-eligible transactions conducted by banks in the U.S. domestic market occur daily. Nevertheless, the Fed's ruling on the domestically located facilities still maintains a strict distinction between the services that will be available to domestic and international customers. Accordingly, the new ruling will not significantly alter the way U.S. banks conduct their banking operations.

To enable U.S.-based banks to establish IBFs, the Fed amended its regulations to exempt IBFs from reserve requirements and interest rate restrictions that other U.S. depository institutions are currently subject to. The Fed ruled that the IBFs will be able to offer time deposits in minimum amounts of \$100,000 and minimum maturity of two business days to foreign resi-

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Briefs

□ When the Social Security tax was established in 1937, the initial rate was 1% and the maximum payment required from both employer and employee was only \$30.00 apiece. Twenty years later (1957), the maximum payment had more than tripled to \$94.50. By 1977, another twenty years, the rate had risen to 5.85% and the maximum payment stood at \$965.25. Now, in 1981, only four years later, the maximum payment is \$1,975, or \$3,950 when both employee and employer contributions are counted.

□ Although the Department of Justice has spent \$12 million preparing its antitrust suit against American Telephone and Telegraph Co., AT&T itself has already spent \$293 million in preparing its defense—even before the cases start. AT&T lawyer George Saunders estimates that if the case is appealed, AT&T's costs may reach \$1 billion. Both the federal government and AT&T have already photocopied a combined total of 20 million documents. The corporation found it necessary to rent three floors of a Washington office building in order to store these documents.

□ The General Accounting Office has reported that in 1979 the Department of Defense awarded approximately \$289 million in noncompetitive procurements that should have been submitted for competitive contract bidding. Although the GAO surveyed only 109 contracts for this report, almost a quarter of these were simply handed out to a single company. In 70% of these cases the request for noncompetitive procurements was not even subject to examination.

□ Although the national debt is coming closer and closer to \$1 trillion (it is now \$972 billion), the federal government is currently in the process of receiving a several billion dollar windfall that will delay reaching a debt of \$1 trillion. Over \$4 billion of World War II war bonds are currently in the process of expiring because of their 40-year limit. Although the Treasury Department is launching a public relations campaign to locate these bondholders, it is probable that most of the bonds have been either lost or destroyed.

□ Recent studies by transit officials indicate that federal programs designed to help the handicapped may turn out to be more expensive than originally planned. It is estimated that it costs the city of Spokane \$186 each time a wheelchair user rides on a handicapped-accessible bus. In Milwaukee this figure is over \$1,000 per trip. The Metropolitan Transit Authority of New York City has computed that it will cost over \$1.5 billion to comply with federal regulations designed to make the city's transit systems accessible to the handicapped. This figure does not even include the expected annual operating costs of \$400 million. These expenses prompted New York City mayor Edward Koch to remark, "It would be cheaper and more sensible to transport the handicapped by limousine."

□ Economists at the Tax Foundation report that the average American family will finish 1981 \$427 poorer in real purchasing power than it was a decade ago. The family has received a nominal increase of 125% in its income, but federal tax burdens have more than tripled since 1971, while inflation has cut purchasing power by nearly 56%. After-tax income has dropped in real terms every year since 1975. This study does not include the effects of state and local taxes. The Tax Foundation also reports that total government spending in the United States will amount to just over \$1 trillion in 1981—\$4,678 for every citizen, or \$13,211 for each American household (which contains an average of 2.8 people). Total spending is up 71% in just five years. ■

Free-Trade Zone (Cont. from p. 5)

dents (other than banks). Time deposits of at least \$100,000 with a one-day (overnight) minimum maturity can be offered to foreign banks, to other IBFs, and to the parent institution of an IBF. Credits can be extended to these same entities, and the loans and deposits booked at IBFs may be denominated in either U.S. dollars or in foreign currencies.⁵

These regulatory changes, coupled with provisions in state and local laws that will exempt the international transactions booked at these facilities from state and local taxes, will enable U.S. banks to establish free-trade zone banking facilities in this country. To date, IBF legislation has passed the legislatures and been signed into law in Connecticut, Florida, Georgia, Maryland, and New York. IBF legislation is pending in California, Hawaii, Massachusetts, and Illinois. Hence, although the move to establish IBFs originated in New York and the bulk of the activity conducted through these facilities will probably be concentrated in New York City, IBF centers are expected to be established in many states throughout the country and will provide another precursor of interstate banking in the United States.

As noted earlier, the IBFs will enable a significant portion of the international banking transactions conducted and booked through offshore branches, particularly those in the Bahamas and the Cayman Islands, to be legally conducted at a domestic facility. Many U.S. banks favor this policy change because the move to consolidate some of their international transactions at a domestic location will result in some cost reductions and efficiency gains. In addition, by conducting a larger portion of their international transactions at these domestic facilities, the U.S. banks will reduce the foreign risk exposure that they and their customers currently bear. Both the banking community and the regulators anticipate that these regulatory changes will marginally increase the flexibility that U.S. banks will have in conducting international banking transactions. The IBFs, however, unlike other offshore branches of U.S. banks, will be eligible to offer only *nonnegotiable* time deposits of

two-day minimum maturity to non-bank foreigners, whereas the offshore Eurocurrency branches of U.S. banks can offer one-day (overnight) negotiable time deposits to such customers. Since one-day call money placed overnight with banks is a widely uti-

"The U.S. domestic money market is already tightly linked with money market operations throughout the world."

lized Eurocurrency deposit instrument, particularly by the highly sophisticated Treasury functions of most multinational corporations, the two-day restriction on IBF deposits will probably prevent most U.S. banks from actually closing their offshore branches even after they have opened the new domestic free-trade zone facilities. The volume of transactions with maturities over one day, however, will probably drop off significantly at the offshore centers once the IBFs are actively operating.

Monetary Policy

The decision to place the more restrictive maturity constraint on IBF deposits was based on monetary policy considerations. By restricting the minimum maturity of IBF deposits to two days, the Fed hopes to minimize the potential for eligible non-bank customers from utilizing the overnight money market to shift between non-interest-bearing domestic demand deposits and interest-bearing IBF deposits. Federal Reserve officials are concerned that erratic shifting between domestic transaction balances subject to reserve requirements and IBF deposits that will not be subject to reserve requirements would further increase the difficulty of controlling the available supply of bank reserves in the domestic money market. Similarly, the restriction that IBF time deposits cannot be negotiable was aimed at inhibiting non-eligible domestic depositors from purchasing interest-bearing IBF deposits in the CD secondary market where such

deposits are likely to be actively traded. This restriction on the negotiability of IBF deposits is again aimed at minimizing the ability of U.S. residents to gain access to the Eurocurrency markets through the U.S. commercial banking system.

In reaching the policy decision to allow IBFs to be established in the United States, the Fed's determination to try to preserve domestic autonomy by maintaining a distinction between the types of services available to domestic and international customers remained steadfast. This policy decision clearly reflects the Fed's view that strictly domestic banking customers are not eligible to participate directly in Eurocurrency transactions via their local bank. The Fed maintained this position despite the fact that domestic customers can already gain access to the Eurocurrency markets by purchasing such money market instruments from most of the major U.S. brokerage houses that actively participate in both the domestic and international money markets.

The Fed's decision to maintain regulatory restrictions that prevent the U.S. domestic banking network from offering services already available in the international banking arena does place U.S. domestic banks at a competitive disadvantage, not only with other banks that can operate more freely in the Eurocurrency markets but also with the internationally-linked brokerage houses that have become a major competitor to U.S. commercial banks as well as to thrift and savings institutions.

A Minor Step

The Fed's ruling on the IBFs reflects a minor step toward bringing its domestic regulatory policy closer in line with the manner in which global money market operations are already being conducted. In essence, however, the policy change really reflects only a willingness on the part of Federal Reserve officials to allow U.S. banks to *book* eligible international transactions at the new domestic locations. Such transactions were already being *conducted* at domestic locations. Of more importance, the Fed's determination

Regulatory Watch

SECURITIES AND EXCHANGE COMMISSION

At a recent press conference SEC chairman John Shad announced a number of steps the SEC may take to partially deregulate the stock market and the securities industries. These steps include:

1. A review of regulations requiring brokerage firms to maintain a certain quantity of liquid assets.
2. A review of prescribed accounting procedures, with a view toward their simplification.
3. A review of rules that require large utilities to get SEC approval on any major financing, merger, or acquisition decisions.
4. A review of the possibility of instituting a system of self-regulation for investment companies and investment managers.

The SEC is considering the possibility of giving the Securities Investor Protection Corporation (SIPC) the power to require mergers between financially troubled securities firms and stable firms. Presently, the SIPC may liquidate only failing firms, a step John Shad described as "drastic, time-consuming and expensive." In order for this authority to be granted to the SIPC, legislation would have to be introduced in Congress.

A request filed by the Options Clearing Corp. that would enable the company to issue options on Government National Mortgage Association (GNMA) securities and to clear and settle any outstanding GNMA options transactions has been approved by the SEC. The proposed change was filed by the OCC for the purpose of facilitating the trading of GNMA securities on exchanges in which the OCC participates. A similar request has recently been suggested and approved from the Chicago Board Options Exchange Incorporated to allow for GNMA trading.

The SEC has devised new registration forms for all public companies and other issuers of securities. These forms are mandated by the Securities Acts of 1933 and 1934 for all companies that wish to sell securities to the public and require the firm in question to submit detailed information to the SEC regarding their financial condition. In addition to these reports, the companies are also required by either the SEC or state laws to produce similar information for their stockholder reports. The new SEC registration form is designed to reduce the duplication of many of these information requirements.

John Shad has offered to amend regulations on the distribution of securities by the International Bank for Reconstruction and Development ("World Bank"), the Inter-American Development Bank, and the Asian Development Bank. The new amendments would allow these banks to sell their securities immediately upon filing certain information with the SEC, rather than having to wait seven days.

The SEC is simplifying the investment company prospectuses that investment companies are forced to send to their patrons prior to any actual transactions. Such prospectuses are required by the Investment Company Act of 1940 and usually contain information about a company's assets and liabilities and the company's future plans. The new rules for prospectuses would reduce the number of items needing to be disclosed and change the format of the prospectus by simplifying many of the informational requirements. SEC officials claim the new rules would benefit both investment companies and investors because the new prospectuses will be easier to read and easier to prepare.

to try to preserve domestic autonomy by differentiating between the services available to resident and nonresident customers remained unchanged. This decision reflects both the Fed's commitment to try to isolate the domestic money market from the international market in order to conduct independent monetary policy operations as well as its willingness to preserve regulatory constraints that inhibit competition among U.S. banks in the domestic banking system. Many U.S. banks actively support this policy approach of limited competition. However, as underscored by the profitability problems most thrift institutions operating in this country currently face, the ultimate cost of regulations aimed at isolating one sector of a market from competition from other sectors can be the eventual demise of that industry.

In today's financial environment regulators as well as market participants cannot lose sight of the fact that the U.S. domestic money market is already tightly linked with money market operations throughout the world. Virtually all the major U.S. banks with worldwide branch networks now utilize global asset liability management techniques to coordinate their efforts to raise and allocate funds on a global basis. Their goal is to minimize the bank's total cost of funds and maximize its asset yield. Multinational banks hold and operate diversified currency portfolios both for their customers and for their own accounts. Domestic interest rates are quickly influenced by rate movements in other money and capital markets. Accordingly, it is becoming increasingly difficult for the central banking authorities to isolate their domestic markets from market conditions that develop in the unregulated Eurocurrency markets. In fact, rapid market adjustments aimed at bringing interest rates and exchange rates toward their market equilibrium levels have provided the major constraint against the continuation of inflationary monetary policies. An increasing number of policy makers as well as market participants appear to be accepting this view. Let us hope that the Fed will move with deliberate speed toward

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✓ Washington Update

✓ Assistant Attorney General William B. Reynolds has announced that the Justice Department will no longer use such traditional tools as busing and hiring quotas for enforcing laws against racial discrimination. Reynolds said that the Justice Department plans to limit remedies for discrimination to those cases where an individual can prove he was harmed by discriminatory action. A Justice Department spokesman later added that although there will be no specific minority hiring goals, there will still be checks to make sure that the percentage of minorities hired is close to the percentage of minorities in the applicant pool.

✓ The Economic Regulatory Administration of the Department of Energy is currently settling its charges that oil companies systematically overcharged consumers during the years of price controls. The latest settlement reached was with Standard Oil of California (Chevron) for \$82.5 million. This figure includes several different categories of payments, including \$10.5 million for Chevron's refiners, \$25 million to state governments, and \$14 million for the federal Treasury.

✓ Overriding strong objections from budget director David Stockman, President Reagan approved more than \$3 billion in loan guarantees for two synthetic fuels projects. One of these loans was for a coal gasification project in North Dakota, while the other was for oil shale extraction in Colorado. Reagan has also recently approved another \$400 million in price supports for a shale oil project in California.

✓ The Reagan administration has issued its own revision of rules proposed by the Carter administration for protecting workers from on-the-job noise. Unlike Carter's plan, the Reagan administration rules do not tell employers how to comply with the noise limits imposed. These regulations cover over 2 million workers in sawmills, oil fields, textile mills, and ship-

yards. OSHA has estimated that it will cost industry \$181.5 million annually to comply with these rules.

✓ President Reagan has asked the Civil Aeronautics Board not to lift the antitrust immunity granted to domestic airlines to cover their price-fixing activities on North Atlantic routes. Such immunity was supposed to have been lifted on 15 September as part of the airline deregulation plan of 1978 but was met with strenuous objections from several European nations who saw the CAB order as a unilateral attempt to undercut reciprocal air-pricing agreements with European nations. President Reagan indefinitely deferred the lifting of immunity as a gesture to the cooperation that European governments have offered the U.S. in dealing with the air traffic controllers' strike.

✓ A Reagan administration task force on violent crime has recommended that the federal government strengthen national gun control laws and grant an additional \$2 billion to the states for prison construction. Among the reforms suggested are a mandatory prison sentence for anyone using a firearm while committing a felony, a requirement that individuals report the loss or theft of any handgun, and a ban on the importation of unassembled handgun parts.

✓ The Consumer Product Safety Commission has recently been restructured so that the agency may issue rules only in response to outside recommendations or proposals. Even after a rule is completely drawn up, it is still subject to congressional veto. This restructuring is the result of a compromise between President Reagan, who had promised to abolish the agency, and Congress, which wished to preserve it.

✓ The U.S. Court of Appeals handed President Reagan a setback when it ruled that Reagan's federal hiring freeze of last

January was an illegal cancellation of work commitments to the 20,000 potential federal employees who were sent job letters between the time of Reagan's election and his inauguration. In order for the federal government to continue to refuse to hire these people, it must now prove that the jobs destroyed by the hiring freeze were revoked through proper procedures by the authorized officials in each department or agency.

✓ The Reagan administration has unveiled its new coal export policy designed to maintain America's "... solid international reputation as a reliable supplier of coal." The plan calls for less stringent federal regulations on water projects involving the transportation of coal, including a relaxation of environmental standards for channel dredging and the construction of coal ports. The plan also includes aid to foreign investment in American coal, looser surface mining and leasing regulations, and the initiation of a coal export promotion program through the Commerce Department.

✓ The Department of Agriculture has reaffirmed its intentions to continue publication of "Dietary Guidelines," a 22-page pamphlet advising consumers which foods are healthy. This pamphlet has come under criticism from both the food processing industry and Agriculture Secretary John R. Block. Although 7 million of these pamphlets have already been distributed free, the federal government will now be charging \$1.50 a copy.

✓ Reese H. Taylor Jr., the new chairman of the Interstate Commerce Commission, at a recent press conference pledged his support to the congressional plan to deregulate the ICC. However, Taylor added that he would also like to see the following changes in ICC policy: a closer scrutiny of applicants for operating certificates; a narrower granting of territorial operating rights; and a much stricter enforcement of all ICC rules. ■

Free-Trade Zone (Cont. from p. 7)

deregulating the commercial banking industry in this country. Otherwise the bulk of commercial banks in this country may, like the thrift institutions, become outmoded financial relics. ■

¹ IBFs may be established by U.S. depository institutions, by Edge and Agreement Corporations ("Edge Act Banks" are domestically chartered corporations authorized to engage in international or foreign banking or other international or foreign operations), and the agencies and branches of foreign banks operating in the United States.

² The New York Clearing House Association is a group of New York-based commercial banks that joined together under the association in order to effect bank payment transactions through a central clearing mechanism rather than clearing separately with each commercial bank.

³ U.S. banks are required by Federal Reserve regulations to maintain two identical sets of records on their Caribbean branches: one at the domestic head office and the other at the Caribbean branch office.

⁴ The term "eligible" must again be underscored because it is quite clear from conversations with a number of banking contacts that many U.S. banks

do not undertake the costly search procedures that would be needed to determine whether the deposits booked in their Nassau branches for U.S. residents and businesses do in fact have international connections. Hence it seems likely that some U.S. residents have access to the Eurocurrency markets via their commercial banks.

⁵ The ability to offer foreign-currency denominated loans will differentiate IBF operations from other domestic banking operations because existing U.S.-located banks are not allowed to offer non-dollar denominated deposits nor make non-dollar denominated loans.

Solving the Monetary Crisis

by R. H. Timberlake, Jr.

The apparently unstoppable inflation of the last few years has led many Americans to despair of finding a solution. But the cause of inflation is clear—the increase in the money supply directed by the Federal Reserve System—and it will be stopped only by fundamental changes in the Fed.

The history of the Federal Reserve is typical of a government regulatory bureau. First, a minor social problem is perceived—in this case, occasional, extraordinary, seasonal demands for currency. Second, Congress creates an agency that has limited authority to deal with the problem—the early Federal Reserve System. Next, the new agency independently assumes functions that were never intended within the authority delegated to it by Congress—open-market operations in government securities. Fourth, it fails to function properly and as expected at a critical time and turns a minor problem into a world catastrophe—the Great Depression of the early 1930s. Fifth, pleading lack of sufficient control while denying its own incompetence and misdirection, it secures greatly enlarged powers from Congress—the Banking Act of 1935. Sixth, when its policies subsequently reflect greater vacillation, uncertainty, and political influence—the inflation from 1966 to 1980—Congress widens its pow-

R. H. Timberlake, Jr., is a professor of finance at the University of Georgia. This essay is excerpted from a recent Policy Analysis published by the Cato Institute.

ers—the Depository Institutions Deregulation and Monetary Control Act of 1980.

Can it ever occur to Congress that delegating greater and greater discretionary powers to a regulatory agency is a blueprint for disaster? Is it impossible for Congress to recall that monetary behavior without a central bank, although not perfect, was much more stable, predictable, and productive than monetary policy under the discretion of a central bank?

Congress should deal candidly with the inability of the system to function as intended. One option that could be pursued is drastic limitation of the power of the Board of Governors (and of the larger Federal Open Market Committee) to control the monetary system. Congress, by its constitutional authority "to coin money and regulate the value thereof," has the duty of specifying rigorously the growth rate in the monetary base—the explicit accountable variable over which the Federal Reserve System has complete technical control. Another option is for Congress to bring central banking functions under the authority of the executive branch so that monetary policy can be made compatible with a given administration's general economic policy. Either change would greatly improve the present institutional structure, which allows the central bank unlimited monetary powers with no corresponding accountability for its actions.

A final option, and a true institutional reform, would begin with abolition of the Federal Reserve System as a policy-making central bank. How would the monetary system operate without the Federal Reserve System? Certainly the entry and exit regulation of commercial banks could be disposed of immediately. Banks have no more reason to be regulated than grocery stores. They should be left alone to justify their existence in a free-market system by means of the functions they perform.

The technical check-clearing operations of the Federal Reserve Bank could still be handled by the existing physical facilities. Federal Reserve Banks could be reorganized as regional bank clearing houses. Since the Fed banks are already legally owned by commercial banks that exercise no control or ownership, the solution is simple: Turn the Federal Reserve Banks over to the legitimate owners and let the member banks operate them. This change would probably result in many interesting innovations and economies in bank management and checking facilities.

The final issue deals with the decision-making policy functions of the Fed. There is no need to spend any time at all on reserve requirements or discounting for member banks. At worst, the elimination of reserve requirements would only throw this particular regulation back to the states. Illinois has no reserve requirements

of any sort, so this constraint is already seen to be completely unnecessary. The banks can manage their own reserve necessities. (No other system in the world employs reserve requirement laws to regulate commercial banks.) The discounting function is both unnecessary and undesirable. It is a small element in the Fed's total monetization program. Most banks borrow needed reserves from, and lend excess reserves to, each other in a well-organized private market, the Fed funds markets. Ending Federal Reserve discounting, therefore, would simply be ending something that is largely an advertising gimmick for promoting the image of the Fed as a banker's welfare agency.

What would take the place of open-market operations and the monetization of government securities, the process that keeps the money stock growing at inflationary rates?

The answer to this question includes a golden opportunity. The U.S. Treasury holds about 260 million ounces of gold, which it obtained in the 1930s on the basis of a law of questionable constitutionality. This inactive stock has no utility for any-

one and requires real resources for its custody. Let this gold be sold or distributed pro rata to every U.S. citizen—approximately 1.12 ounces per person—either in the form of coin or in certificates redeemable in coin. At the same time, abolish the policy-making structure of the Federal Reserve System—most notably, the Board of Governors and its allied bureaus in Washington.

Finally, freeze the outstanding volume of federal reserve notes, the legal tender paper currency in general use today, and convert all member bank reserve accounts at Federal Reserve Banks into Federal reserve notes that the commercial banks would hold in their own vaults or own as deposits in their "new" clearing houses. The new gold, liberated from government custody, would be deposited in banks and would give rise to gold-based deposits that would require redemption in gold (or federal reserve notes at the option of the depositor). This new system would not be a gold *standard* because the government would not declare gold or anything else legal tender. The existing legal tender federal reserve notes would be left as is in the

system because the harm they do has already been done; and to recall and retire them would have unnecessary and undesirable side effects.

Gold-based deposits and currency would circulate side by side with the frozen stock of existing federal reserve notes. Prices of gold in terms of other moneys would be quickly determined by market factors. The banking industry would become competitive and, therefore, innovative.

Most notably, the great uncertainties in economic life caused by the current on-again, off-again policies of the Federal Reserve Open Market Committee would disappear. Prices would stabilize. The monetary system would become good, if not perfect. It would produce good money for the same reason that a shoe industry or an electronics industry produces good shoes and good calculators: because the self-interests and profits of both consumers and producers of these products are maximized when the items produced are of good quality. We could hardly expect less from a private enterprise monetary system. ■

PR Reviews

Competing: The Enterprise of Business by L. E. Birdzell. National Chamber Foundation, Washington, D.C., 1981. \$12.95

Although several excellent books in the last few years have criticized the modern neoclassical economic theory behind antitrust policy (see Duncan Reekie's *Industry, Prices, and Markets* and Israel Kirzner's *Competition and Entrepreneurship*), there has never been much work criticizing antitrust policy *directly* by empirically applying this analysis. This book, put out by the National Chamber Foundation, provides us with a thorough critique of our modern antitrust practices. Birdzell shows that, far from ensuring competition, antitrust often stifles competition by penalizing efficient firms.

The author focuses his main attack on the "structural" approach to competition,

a theory which argues that the competitiveness of an industry can be measured by the number and size of firms in that industry. Birdzell refutes this claim by both theory and fact, demonstrating how competition is a complex *process*, whose essence cannot be captured by static economic models: "A simple concentration ratio structuralism is still at the heart of the beliefs of those who see 'market rigidities' almost everywhere, but it has few remaining adherents among knowledgeable economists. The key assumptions and the controversial statistics offered in its support have been proven wrong."

Although *Competing: The Enterprise of Business* is an excellent exercise in applied economic theory, its primary concern is with public policy, and it is written on a level highly accessible even to those with no background in economics.

Equality, the Third World, and Economic Delusion, by P. T. Bauer. Harvard University Press, 1981. \$16.95.

A tremendous amount of material is written each year about the problems of developing ("Third World") nations, but very little of it contains anything even remotely resembling a free-market perspective. Therefore the publication of a new book by P. T. Bauer, perhaps the world's leading advocate of the market economy for underdeveloped nations, is clearly an event to be celebrated.

Bauer's book is a collection of essays on the problems of the Third World, covering such varied topics as the lure of egalitarianism, the overpopulation myth, the harmful effects of foreign aid, and the success of Hong Kong. In all of these essays Bauer is clearly at his best when he is on

the attack. In his long chapter on foreign aid, Bauer systematically examines and then refutes all of the arguments used for foreign aid. The chapter on population convincingly demonstrates that overpopulation is not the problem that Third World nations face.

Bauer not only succeeds in tearing down the case for central planning and foreign aid in Third World nations, but he also builds a strong case for the market economy. The free enterprise system was responsible for both the industrial revolution that developed the western world and the development of such modern-day successes as Hong Kong. Bauer points out that if the United States is truly interested in helping the Third World it "... can contribute to Third World development best by reducing its barriers against Third World exports."

The analysis in this collection is nearly flawless, although Bauer has an unfortunate tendency to apologize for Western colonialism. This is one of the best books available on Third World problems.

The Politics of Regulation, ed. James Q. Wilson. Basic Books, 1980. \$18.95.

Both the election of Ronald Reagan and the recent partial deregulation of the trucking and airline industries have intensified the focus of national attention on government regulation of business and industry. Almost every sector of the American economy, from labor markets to the pharmaceutical industry, is heavily regulated by the federal government, and in almost every area this regulation is the subject of intense controversy.

The Politics of Regulation, a collection of essays edited by Harvard political scientist James Q. Wilson, is an important addition to the debate over regulation because it attempts to explain the historical origins of regulatory agencies and the ways in which these agencies make decisions. Most of the essays offer a pluralist explanation of the origin and functions of regulation, meaning that regulations are supported and influenced by a broad and diverse group of interests. Writes Wilson in his conclusion, "What is striking about

the origins of the regulatory programs studied in this book is that in almost every case, the initial law was supported by a rather broadly-based coalition. Sometimes industry was eagerly and happily a part of that coalition (as with the CAB and the PUCs), sometimes it was a reluctant partner ... and sometimes it was an outright opponent."

Among the regulatory agencies covered in this book are public utility commissions, the Civil Aeronautics Board, the Federal Trade Commission, the Food and Drug Administration, and the Environmental Protection Agency. In each case, this book offers a plethora of useful facts on the origins and operation of these agencies. ■

GOVERNMENT RECEIPTS MONITOR

On a quarterly basis, *Policy Report* presents three monitors of economic activity: "Government Spending," "Government Receipts," and "Inflation." This month, the "Government Receipts Monitor" summarizes the latest levels and sources of the federal government's income.

RECEIPTS (annual rate in millions of \$, unless otherwise indicated)

	1981 Second Quarter	1981 First Quarter	1980 Fourth Quarter	Average for Last 4 Quarters
Total Receipts	634,108	625,292	524,200	581,051
Surplus or Deficit	64,964	-128,208	-134,220	-81,703
Total Individual Income Taxes	434,840	309,340	266,950	319,018
Gross Corporate Income Taxes	116,816	59,376	58,108	70,962
Employment Taxes and Contributions	188,308	172,056	124,408	157,110
Social Insurance Taxes and Contributions	222,212	189,432	142,412	180,174
Unemployment Trust Fund	26,780	10,036	11,168	15,947
Excise Taxes	47,724	40,056	28,996	37,277
Highway Trust Fund	6,164	6,640	6,228	6,346
Estate and Gift Taxes	6,652	6,384	6,680	6,758
Customs Duties	8,284	7,420	7,328	7,643
Miscellaneous	13,560	12,388	12,981	12,804
Holding of Public Debt Securities (current total)	971,174	950,498	910,062	929,822
Holding of Agency Securities (current total)	6,176	6,399	6,531	6,444
Federal Securities Held by Public (current total)	775,973	763,449	720,461	739,494

Source: Monthly Treasury Statement of Receipts and Outlays of the United States Government.

"To be governed..."

Today the Skyline Inn, tomorrow the world

An event last year shows how complex the [AT&T antitrust] supercase has become. When trial Judge Harold H. Greene ordered both sides to narrow the 1,872 pages of government accusations, both sides sat down around a single table. Within weeks, they had taken over the entire second floor of the Skyline Inn in Southwest Washington, more than 300 attorneys and paralegal aides in 29 rooms, smothered in documents.

—*Washington Post*, July 19, 1981

Every penny counts

A dime won't even buy penny candy any more, but to Uncle Sam it can be worth a lot more than 10 cents.

The government is demanding that a Chinatown woman pay a \$28.15 penalty because she underpaid her 1980 taxes—by a dime.

In an Aug. 3 letter to Chan Wing, 59, the Internal Revenue Service said: "Unpaid tax on return is 10 cents. Penalty charge is \$28.15. Balance due to IRS is \$28.25. Make check payable to IRS."

(New York) *Daily News*, Aug. 7, 1981

Diamonds are not forever

At the tale-end of a busy day, the taxpayer stopped to buy groceries. She was at the check-out stand when she noticed, to her horror, that the \$10,000 diamond was missing from her ring. The stone had been

knocked from its mounting, but where? She searched everywhere, but never found it.

But when she wrote off the uninsured stone as a casualty loss on her federal income tax, the Internal Revenue Service denied the deduction. "Casualty" means a specific misfortune, the IRS argued, and the taxpayer could not pinpoint a specific event that knocked her diamond loose.

—*Washington Post*, Aug. 18, 1981

Land of free enterprise

A Boone [N. C.] gas station owner says he'll go to jail rather than stop flying his 600-square-foot American flag.

Conley Winebarger, building inspector and zoning enforcement officer for the town, Tuesday ordered Hill Greene to take down the flag because it violates a town ordinance prohibiting flashing signs, streamers and oversized flags.

—*Washington Post*, June 25, 1981

What Constitution?

Tax protesters flood the Tax Court with "thoroughly meritless" cases, says Judge Raum; it's time to "deal summarily and decisively with [them] without engaging in scholarly discussion of the issues."

—*Wall Street Journal*, July 8, 1981

Telling it like it is

Sen. John C. Danforth (R., Mo.), for one, acknowledges the inconsistency between his ostensibly conservative philoso-

phy and his push to introduce new protectionist measures. "I keep telling myself I believe in the free market, I don't believe in bailouts," Mr. Danforth notes wryly. "But I keep voting for them."

—*Wall Street Journal*, Aug. 17, 1981

The world's greatest deliberative body "Frankly," [House Majority Leader James] Wright told reporters, "we'll put it in the [tax] bill if it will buy votes." . . .

Mr. Wright said [an amendment] would go in the bill only if it could insure a Democratic victory, because the protests from Northern liberals would be too great otherwise. . . .

"The price continually goes up," moaned one Democratic leader. "The Republican Administration keeps increasing the bidding, and members are reluctant to take any price till it comes down to the last minute."

—*New York Times*, July 18, 1981

We don't make these up, you know

The Common Market yesterday asked member governments to enforce better working conditions for chickens.

—*San Francisco Chronicle*, Aug. 4, 1981

Casting a critical eye on the artistic merit of beaded jewelry sold by some street artists, the San Francisco Art Commission yesterday set stricter standards for the wares.

—*San Francisco Chronicle*, Aug. 4, 1981

POLICY REPORT

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