STATEMENT ON

THE CREDIT DEREGULATION AND
AVAILABILITY ACT OF 1983

PRESENTED TO

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

BY

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9:00 a.m.
Tuesday, April 12, 1983
Room SD-538 United States Senate

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Mr. Chairman:

I am pleased to have the opportunity to testify on S. 730, a bill to amend the Depository Institutions Deregulation and Monetary Control Act of 1980. The latter bill, among other provisions, preempted state usury limits on residential first mortgages and established minimum ceilings on certain agricultural and business credits for a three-year period which ended March 31, 1983. With respect to both of these provisions states were given three years during which they could override the Federal preemption.

S. 730 would eliminate interest rate ceilings altogether on the same covered areas of agricultural and business credit and eliminate rate ceilings on consumer credit. Ceilings would also be removed on all loans of Federal credit unions. S. 730 would permit states to override the Federal statute during a three-year period following its enactment and, in addition, any state action previously taken to override the 1980 Act would continue to be in force. If S. 730 is enacted, it could, for all practical purposes, eliminate usury ceilings altogether in states that have not overridden provisions of the 1980 Act and choose not to override S. 730.

The FDIC endorses S. 730. We believe that usury ceilings are an impediment to market behavior and that these ceilings adversely affect all sectors of the economy. The case against usury ceilings has been well documented in theoretical and empirical studies. Those parties most directly impacted by ceilings in those states with the most restrictive ceilings have been among the strongest advocates of revision, providing practical evidence of the perverse nature of restrictive ceilings.

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A recent study of the impact of the ceiling on consumers in Arkansas documents how ceilings acted to reduce consumer options, to channel financing to more costly and less efficient alternatives, to raise credit standards and limit terms so that lower income consumers were rationed out of the market, and generally to affect the economy in a perverse manner. Other studies and more casual observations indicate similar and equally perverse results in other situations where usury ceilings have been very restrictive.

The Depository Deregulation and Monetary Control Act of 1980 set minimum ceilings on agricultural and business loans that were tied to the Federal Reserve discount rate. Many have testified against the appropriateness of tying ceilings to an administered short-term rate (I did in testimony on S. 1406 and S. 963 two years ago). We are pleased that S. 730 sets no rate-tied ceiling. While better choices exist than the discount rate, there is no assurance that a market-tied ceiling won't become overly binding at some future date. We favor the provisions of S. 730 which eliminate ceilings altogether, if states don't act to override. Also, we strongly favor the inclusion of consumer loan rates in the Bill.

The best assurance that potential borrowers have access to credit on terms consistent with risk, prevailing interest rates and the overall demand and supply of savings comes from the maintenance of competitive markets in the financial services industry. Usury ceilings actually reduce competition and the alternatives available in local credit markets. They tend to injure the very people they are intended to aid by denying them access to credit.

During the last few years Congress has taken important steps to increase competition in financial markets. Thrift powers to lend in business and consumer credit markets have been substantially increased, and many states

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have responded to Federal action by liberalizing lending options for state-chartered institutions. Interest rate ceilings have been substantially liberalized. While some restrictions remain (which we hope will be dismantled soon), it is not much of an exaggeration to say that depository institutions are unregulated with respect to what they can pay for funds. And that's certainly true of their competitors. This has resulted in market situations where outside competitors can easily penetrate local markets wherever institutions pay significantly less than prevailing market rates. Competition has been substantially expanded for retail deposits.

In order to earn satisfactory returns on funds that are no longer available at bargain rates, lenders are under pressure to seek out loan alternatives in their traditional trade areas or, if necessary, in other areas. Thus, fewer markets will be insulated. Competition has been increased and that increase is likely to spread. As a result, we do not see any need to protect borrowers from "excessive" rates. If community banks and thrifts are to be viable competitors in the marketplace they will have to be able to earn market rates on consumer, business and agricultural loans. If they can't, they won't be able to pay market rates for deposits. Deposits will shift to depository and other financial institutions in other parts of the country that pay higher rates. As a result ceilings will adversely affect local institutions, limit local borrowing options and adversely affect those that ceilings are supposed to protect.

We note from the financial press that recent declines in interest rates may remove pressure to abolish ceilings through Federal legislation. It is true that not as many state ceilings are below market rates today than at some times in the past. However, nobody can forecast interest rates with a great

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deal of confidence. Too many external forces can affect rates and, in the past, they have. We see no reason to have second thoughts about eliminating ceilings now, just because doing so is not that urgent.

We believe, and I have already suggested, that credit markets have become more and more national markets. No one would question this with respect to large corporate credits. Indeed, many foreign banks have penetrated lending markets for what used to be considered regional firms, let alone the lending market for national firms. In consumer and real estate markets there are many national participants including bank and affiliates and major nonbank financial conglomerates. We are not overly troubled by Federal preemption in this area as S. 730 does give states the option of overriding the elimination of ceilings as did the 1980 Act. We understand that about 15 states took advantage of this option in the last three years, although some merely preserved their future options without imposing ceilings.

Mr. Chairman, the FDIC supports S. 730.

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