Statement by

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before the

Subcommittee on the Legislative Process

and the

Subcommittee on the Rules of the House

of the

Committee on Rules

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I am pleased to present this statement in response to your request for the views of the Board of Governors of the Federal Reserve System on Title V of H. R. 2, the Sunset Act of 1979, H. R. 65, the Legislative Oversight Act of 1979, and H. R. 2364, the "Regulatory Reform Act of 1979." My statement will be directed for the most part to H. R. 2364 since that bill is specifically applicable to the Board of Governors. Reference will also be made to Title V of H. R. 2 because it apparently is a modification of H. R. 2364.

As your Committee knows, there has been one recent significant change in the approach to regulations, the issuance of executive Order 12044 of March 23, 1978, which requires that regulations of the Executive agencies not impose unnecessary burdens on the economy, on individuals, on public or private organizations, or on State or local governments.

To achieve these objectives the Executive Order requires regulations to be developed through a process, which among other things, ensures that the need for the regulations are clearly established, meaningful alternatives are considered and analyzed, and compliance costs, paper work and other burdens on the public are minimized.

In addition, the Executive Order mandates the periodic review of existing regulations to determine whether they are achieving the policy goals of the Order.

The Federal Reserve, consistent with the purposes of the Order, has adopted expanded rule-making procedures of its own, which require, in most cases, 60-day comment periods on regulations and more detailed analyses of the potential costs and benefits of regulatory and nonregulatory alternatives.

The Board has also undertaken a regulatory improvement program that involves a substantive zero-base review of each Federal Reserve regulation to determine (1) fundamental objectives and the extent to which the regulation is meeting current policy goals, (2) costs and benefits of the regulation, (3) any unnecessary burdens imposed by the regulation, and (4) nonregulatory alternatives that might be used to accomplish the same objectives. The Board's program also contemplates procedures for reviewing each regulation at least once every 5 years.

Our regulatory review program has enlisted the services of the Federal Reserve banks as well as staff of the Board. It has progressed rapidly. The Board has issued revised versions of Regulation K (Corporations Engaged in Foreign Banking under the Federal Reserve Act), Regulation O (Loans to Executive Officers) and V (Loan Guarantees for Defense Production). The Board, as part of its regulatory review, has also rescinded Regulation S (Bank Service Corporations) and Regulation E (State and Local Warrants).

Although much has been accomplished under Executive Order 12044, the Board supports the basic objectives of H. R. 2364. We are keenly aware that government regulation of various aspects of economic activity may introduce distortions and inequities into the economy. Despite laudable objectives, there is little doubt that both Federal legislation and the regulations implementing that legislation have sometimes resulted in a lessening in competition, a reduced resilience to deal with economic change, and a higher and more rigid structure of costs and prices which the consuming public must inevitably bear.

It is clear also that regulation has contributed to the inefficient use of real resources in the economy. When regulated businesses are precluded from competing directly on a price basis, they are likely to adopt indirect means of promoting their business. Banks and other depository institutions, for example, frequently offer free services and give away merchandise in their efforts to attract new funds when price competition is limited by interest rate ceilings on deposits.

Federal law and regulation have sometimes had the effect of fostering monopolistic and cartel-like behavior on the part of ostensibly competing firms by insulating these firms from the discipline of effective competition. On other occasions, regulatory action may preserve the inefficient marginal firm, or divert resources to less than the most productive uses through the offering of special advantages to certain industries at the expense of consumers.

A balanced view needs to recognize that much Federal regulation promotes the public interest and contributes to the performance of the economy. For example, regulation designed to maintain the safety and soundness of individual banks is critical to the strength of the financial system and the efficient functioning of the economy as a whole. In the area of securities regulation the SEC disclosure requirements help make needed information available to aid investor decision-making and increase the efficiency of securities markets. But it is an important discipline to review and evaluate outstanding regulations on a periodic basis to see whether they are still justified, can be simplified or need to be modernized in light of recent developments.

While the Board agrees with the general thrust and objectives of H. R. 2364, there are certain key features with respect both to its coverage and method of implementation that we believe need to be revised. We are especially concerned with the so-called "sunset" provisions that require the termination of, first, regulatory enforcement authority and, second, the entire agency in the event that no reform plans are enacted within the prescribed time period. There are several reasons for questioning the advisability of using such a strong forcing mechanism in order to assure that the necessary regulatory reform will take place.

First, many Federal agencies, pursuant to their legislative mandates, perform a variety of functions that are not basically regulatory in nature, but that may still depend in part for their implementation on enabling rules, orders, and regulations. In the case of the Federal Reserve Board, for example, such responsibilities include: (1) its central banking function with regard to international finance; (2) the formulation and implementation of monetary policy; (3) oversight activities with respect to the Federal Reserve Banks, which in turn play a pivotal role in the operation of the nation's payments system; (4) its rules for the administration of the discount window, through which the Federal Reserve System serves as the lender of last resort to the banking system and, in critical situations, to the economy as a whole; and (5) the supervision of member banks and bank holding companies. In comparison with these functions, the Board's strictly regulatory responsibilities for banking and finance, including its role in consumer credit protection, account for a relatively small portion of the agency's efforts or for the impact of its actions on the economy.

The coverage of H. R. 2364, in the case of the banking agencies, specifically refers to their "regulation of banking and finance." It would appear, therefore, that the intent is not to discontinue all non-regulatory functions, or to dismantle an entire agency, for want of reform plans to cover the agency's regulatory functions. We believe that the Congress would not want to risk the abolishment or suspension, even temporarily, of the conduct of monetary policy or the supervision of banks. Similarly, we would be deeply concerned if there were no central oversight of the operation of the Reserve Banks and the payments mechanism, or of the discount window function.

Such potential problems are by no means unique to the Federal Reserve Board. For example, what would become of the deposit insurance function of the Federal Deposit Insurance Corporation or of its role with respect to the banks requiring liquidation? I should also point out that the Comptroller of the Currency is the chartering and supervisory authority for national banks, and these activities, too, would be suspended in the event of termination of that agency. Surely these functions should continue.

For these reasons, we must assume that the bill is directed to the purely regulatory activities of the agencies and would not, in the case of the Federal Reserve Board, encompass central banking, monetary policy, oversight of the Reserve Banks, operation of the discount mechanism, bank supervision and the incidental regulations of the Federal Reserve necessary to carry out these functions.

However, in order to avoid any doubt about the continuation of these essential functions, the Board would urge a narrower and more specific delineation of the aspects of regulation of banking and finance to be covered by the bill, to which the application of these "sunset" provisions would then be directed.

We believe that Title V of H. R. 2 provides for a more realistic regulatory review program covering fewer programs over a two-year longer time span. In addition, the fact that the Board of Governors is not included among the agencies subject to regulatory review under section 502(a)(1) appears to confirm our assumption that the Board's functions relating to monetary policy, central banking, oversight of the Federal Reserve banks and use of the discount window are not subject to review and termination under the bill. In general, as the Board has previously written to your Committee, we believe that clarification is needed to be certain that the termination procedures of Title I are not applicable to programs that are essential to the functioning of government and the Nation's economy.

The Board has a second concern about the "sunset" mechanism in H. R. 2364. Instead of easing the regulatory climate, the abrupt termination of even the regulatory functions of Federal agencies might present obstacles to the efficient functioning of the economy. Federal statutes are generally implemented by way of agency regulations, and in many cases agency approval pursuant to those regulations is necessary before individuals or firms can participate in certain activities or markets.

In the event the "sunset" provisions of H. R. 2364 were triggered by lack of action on bank regulatory reform, under one possible interpretation this would mean that institutions seeking Board approval would be hampered--not freed--for lack of a regulatory process. Thus, for example, as the Bank Holding Company Act is written, it is unlawful for a bank holding company to be formed without the express approval of the Board of Governors. Similarly, existing bank holding companies wishing to expand or to engage in new activities would be denied the opportunity to have their applications for Board approval reviewed and acted upon. The same situation would exist with respect to applications to the Board for new branch offices, to establish Edge corporations, to engage in foreign banking activities requiring Board approval, or for permission to issue new debt or equity securities--to name a few. The result could be severe inequities for firms who could not obtain Board approval to engage in activities that may have already been authorized for their competitors.

This brings me to another question as to whether the regulatory reform proposal in itself will accomplish the desired purpose of the bill. Since most agency rules and regulations are issued pursuant to the mandates of specific laws and to carry out Congressional intent, it may be that many of the economic problems and inequities caused by regulation are rooted in the enabling legislation itself, rather than in the specific form the regulations have taken.

I would suggest, therefore, that consideration be given to broadening the scope of the review contemplated in the Regulatory Reform

Act to encompass, where necessary, review and reform of the enabling legislation as well as existing regulation. I believe progress in improving and simplifying our Federal regulatory apparatus would often require basic amendments to underlying statutes.

It appears that the incorporation of the regulatory review procedures in Title V of H. R. 2 as a part of the general program review as contemplated by that bill was probably intended to permit such a review of underlying statutes. However, the lack of provisions coordinating the regulatory review in Title V and the program review in Title I leads to uncertainty as to how the two Titles would work together. We believe that additional provisions are probably needed to provide for an effective interrelation between Title V and Title I.

This leads me to one final comment. The Board and its staff have devoted considerable time to the promulgation of regulations required by the Financial Institutions Regulatory and Interest Rate Control Act of 1978. Our recent experiences suggest to me that it might be desirable for the Congress to make more explicit evaluations of relative benefits and burdens to the public and to the industry that would result from new statutory requirements and where the costs are substantial to consider alternative means of accomplishment. It may also be desirable, a year or so after the promulgation of new regulations, for the appropriate Committees of the Congress to review their impact and entertain suggestions for revision of the statutory requirements where appropriate. Our objectives are the same, to reduce the burden of regulation. We hope the Congress and the regulatory agencies will work cooperatively toward this end.

In conclusion, I wish to reiterate that the Board supports the basic concepts of H. R. 2364, the Regulatory Reform Act but believes that further attention should be given to problems of its scope and implementation.