

Congressional  
March-April 1981 [1]



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# **Congressional**

# **March-April 1981**



Action assigned Janet Hart

CARROLL HUBBARD  
CONGRESSMAN  
1ST DISTRICT, KENTUCKY

2244 RAYBURN HOUSE OFFICE BUILDING  
WASHINGTON, D.C. 20515  
(202) 225-3115

Congress of the United States  
House of Representatives  
Washington, D.C. 20515

AT LARGE MAJORITY WHIP

COMMITTEES:

BANKING, FINANCE AND  
URBAN AFFAIRS

MERCHANT MARINE  
AND FISHERIES

CHAIRMAN, SUBCOMMITTEE ON  
PANAMA CANAL/OUTER  
CONTINENTAL SHELF

March 17, 1981

#93

Hon. Paul Volcker  
Chairman  
Federal Reserve System  
20th Street and Constitution Avenue, N.W.  
Washington, DC 20551

Dear Mr. Chairman:

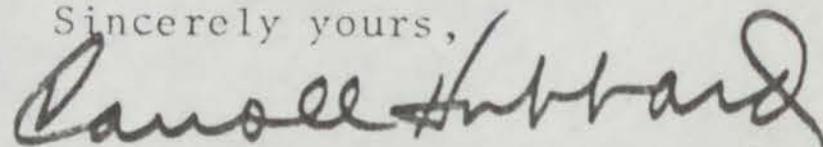
I am writing today on behalf of Mr. Robert M. Duncan, Executive Vice President of the Inez Deposit Bank, Inez, Kentucky 41224, and his interest in being nominated to serve on the Federal Reserve System's Consumer Advisory Council.

I understand that generally, ten members are chosen each year from over four hundred applications and that the Council's membership is intended to represent all interests in the area of consumer financial services regulation. Further, I understand that at present there are no members of the Council from Kentucky.

✓ I would very much appreciate your thorough consideration of Mr. Robert M. (Mike) Duncan for the Consumer Advisory Council.

Thank you for your kind attention to this matter and with best wishes for you, I am

Sincerely yours,



Carroll Hubbard  
Member of Congress

CH:lmg



# United States Senate

WASHINGTON, D.C. 20510

March 19, 1981

#90

The Honorable Paul A. Volcker  
Chairman  
Federal Reserve System  
20th Street and Constitution Avenue, N.W.  
Washington, D.C. 20551

Dear Chairman Volcker:

I am prepared to accept the fact that interest rates are closely associated with the rate of inflation.

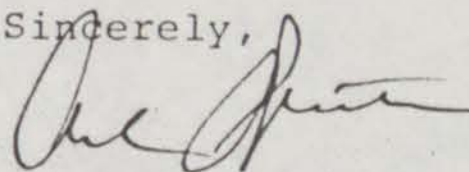
Yet, I am deeply troubled by reports by Pennsylvania businessmen and labor leaders that much industrial and commercial activity is rapidly declining and increased layoffs and bankruptcies can be expected in the months ahead, largely due to the adverse effects of extraordinarily high interest rates on credit and loan activities of all types.

I have advised these Pennsylvanians that I believe the first order of business is enactment by the Congress of the reduced budget, or cuts of equal amount, which we have before us.

I would appreciate a letter from you setting forth your expectations as to how soon after the budget cuts we can experience some relief in the high interest rates. Are there other measures we in Congress should be providing to relieve the deadening hand that high interest rates are exerting on industry and commerce in the State of Pennsylvania and the nation?

Your views would be most helpful to have.

Sincerely,



Arlen Specter

AS/ww



*Can you get the  
FBI to look  
into the  
monetary control  
water?*

March 19, 1980

[REDACTED]  
[REDACTED]

Congressman Bill McCollum  
P.O. Box 732  
Altamonte Springs, FL 32701

Dear Congressman McCollum:

I am writing you concerning the REPEAL OF THE MONETARY CONTROL ACT OF 1980. This was passed as a sneaky action by Pres. Carter's administration. It becomes effective this June 1 and give the "FED" the power to monetize any debt it wants to, even private debt (no doubt CHRYLER- who should never have been loaned one dime) even debt of other nations!!!!!!!

The ulterior motive behind this act was to bail out the international banks who find themselves stuck with worthless loans they made to foreign nations. The spectacle of PANAMA CANAL just won't go away, even giving the canal to a know communist. When will the banks realize you can't buy your way out of any dilemma by asking government to print more paper. This action means a bookkeeping transaction which transfer the banks losses to the American people in the form of rising prices.

What is your stand on this affair and what action are you taking?

I am seriously interested, this could be our last chance to save USA. Urgent action is needed by all the Congress.

Sincerely,

*Mr & Mrs. D. Lamott*  
Mr & Mrs. D. Lamott



MARCH 20, 1981

DEAR SENATOR LEVIN:

I WAS SHOCKED TO LEARN THAT THE  
MONETARY CONTROL ACT OF 1980  
ALLOWS, AMONG OTHER THINGS, THE  
"FED" TO MONETIZE THE DEBTS OF  
PRIVATE CORPORATIONS, STATE AND  
LOCAL GOVERNMENTS, AND EVEN  
FOREIGN GOVERNMENTS. THIS WILL  
ALLOW THE "FED" TO PROTECT THE  
LOANS MADE UNWISELY (IRRESPONSIBLY?)  
TO BANKRUPT CORPORATIONS, CITIES,  
STATES AND NATIONS. RESULT: THE  
CITIZENS OF THIS NATION WILL BE  
CALLED UPON TO MAKE GOOD THE  
INEVITABLE LOSSES - WHICH COULD  
RUN INTO THE HUNDREDS OF BILLIONS OF  
DOLLARS. THIS MAY BE GOOD NEWS FOR  
THE BANKERS BUT AS FAR AS THE  
AVERAGE CITIZEN IS CONCERNED IT IS  
ABSOLUTELY INSANE! I URGE YOU,  
THEREFORE, IN THE STRONGEST POSSIBLE  
WAY, TO WORK FOR THE REPEAL OF  
THE MONETARY CONTROL ACT OF 1980.

YOURS TRULY,

Glenn Harnden

WILLIAM PROXMIRE  
WISCONSIN

Action assigned Mr. Petersen

# United States Senate

WASHINGTON, D.C. 20510

March 23, 1981

Mr. Paul Volcker, Chairman  
Federal Reserve System  
Washington, D.C. 20551

*Paul*  
Dear Mr. Volcker:

Enclosed is an inquiry from a constituent which I hope you can answer. Please respond directly to him and send me a copy of your reply.

Thank you for your assistance.

Sincerely,

*Bill*

William Proxmire, U.S.S.

WP: jkl  
Enclosure



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JAMES K. GALBRAITH,  
EXECUTIVE DIRECTOR

Action assigned Janet Hart

# Congress of the United States

JOINT ECONOMIC COMMITTEE

(CREATED PURSUANT TO SEC. 5(a) OF PUBLIC LAW 304, 78TH CONGRESS)

WASHINGTON, D.C. 20510

March 25, 1981

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PAULA HAWKINS, FLA.  
MACK MATTINGLY, GA.  
LLOYD BENTSEN, TEX.  
WILLIAM PROXMIRE, WIS.  
EDWARD M. KENNEDY, MASS.  
PAUL S. SARBANES, MD.

Mr. Paul Volcker  
Chairman  
Board of Governors  
Federal Reserve System  
Washington, D.C. 20551

Dear Mr. Volcker:

I have become increasingly concerned with the soaring cost of purchasing a home. Inflation and the sharp increase in mortgage rates are causing the dream of home ownership to fade for all but a handful of the new families being formed each year in our country. Two million new households were formed last year, but only 1.3 million new housing units were built -- many at prices far beyond the reach of young families.

The unheard-of level of mortgage rates has also forced banks, saving and loan institutions, credit unions, and other mortgage lenders to reduce mortgage activities. The yield on traditional savings accounts has been overshadowed by the attractiveness of new assets available to savers such as money market certificates. In fact, S&L's alone lost \$28 billion in deposits last year, and the erosion continues today. In the face of a deteriorating housing industry and declining opportunities for home ownership, it is important that all unintended regulatory burdens on the housing industry and home owners be identified and reduced.

Eliminating excessive and unintended regulatory burdens will directly benefit homeowners, prospective homeowners, and the housing industry without costing the Federal Treasury a dime. To that end, I would like for your staff to assist me in evaluating the impact on mortgage lending institutions subject to enforcement activities by your agency of several regulations applicable to home mortgages. Could you please:

1. Determine the costs to these lenders, individually and in the aggregate on a per-application or mortgage-loan basis, of complying with all provisions of:
  - a. The Real Estate Settlement Procedures Act;
  - b. The Home Mortgage Disclosure Act; and
  - c. The Truth in Lending Act regulations which become effective on April 1, 1982.

BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
1981 MAR 27 PM 1:56  
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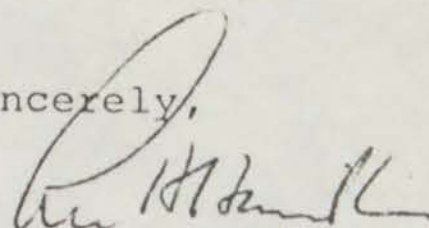
Mr. Paul Volcker  
March 25, 1981  
Page Two

2. Determine the extent to which these institutions making home mortgage loans are required under existing or proposed regulations to provide duplicative or similar information under the Real Estate Settlement Procedures Act and the Truth in Lending Act.

I appreciate the scope of these two tasks. At the same time, I urge you to give priority attention to them in light of the very severe financial difficulties confronting the entire housing industry. If you have any questions, please call me or have your staff contact George Tyler with the Joint Economic Committee at 224-5171.

Best wishes.

Sincerely,



Lee H. Hamilton  
Chairman, Subcommittee on Economic  
Goals and Intergovernmental Policy





Congressional Research Service  
The Library of Congress

Washington, D.C. 20540

July 30, 1980

TO : House Subcommittee on General Oversight and Renegotiation  
Attention: Nancy W. Hunt, Minority Counsel

FROM : Dr. William Jackson  
Analyst in Money and Banking  
Economics Division

SUBJECT : Government bonuses for savings: the German experience

Your request is for a summary of the experience of the West German economy with directly subsidizing the financial saving of low-to-moderate income households. Basing our response upon the materials you have provided us, plus another study that we are attaching, it appears that the German savings subsidies are significant contributory factors to--but not the entire causes of--the higher rates of saving in that country than in America. Although the cost of these programs to the German government appears to be appreciable, they are generally believed to have accomplished much of their aim of contributing to the prolongation of the investment-based German postwar economic "miracle."

Since attaining independence, the Federal Republic of Germany has encouraged private-sector accumulation of financial capital through a number of fiscal measures, which it has modified periodically to direct their emphasis toward low-to-moderate income recipients, especially workers. The current versions of these programs are summarized below, as derived from their description by the West German Embassy and secondary sources in your possession. 1/

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1/ Undated letter from Harald W. Rehm, Financial Counselor, Embassy of the Federal Republic of Germany, Washington, D.C. supplied to CRS by your office. The basic secondary source are Byrne, William J. Fiscal Incentives for Household Saving. International Monetary Fund Staff Papers, July 1976, pp. 455-489; and unpublished testimony by Max Horlick of the Social Security Administration before the President's Commission on Pension Policy.



Action assigned Janet Hart

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EXECUTIVE DIRECTOR

# Congress of the United States

JOINT ECONOMIC COMMITTEE

(CREATED PURSUANT TO SEC. 1(a) OF PUBLIC LAW 304, 78TH CONGRESS)

WASHINGTON, D.C. 20510

March 24, 1981

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PAUL S. CARPENTER, MD.  
OFFICE OF THE CHAIRMAN  
RECEIVED  
MAR 27 PM 1:59  
FEDERAL RESERVE SYSTEM  
BOARD OF GOVERNORS

Mr. Paul Volcker  
Chairman  
Board of Governors  
Federal Reserve System  
Washington, D.C. 20551

Re: Comments on proposed rule to revise Regulation C  
implementing amendments to the Home Mortgage  
Disclosure Act (Docket No. R-0350).

Dear Mr. Volcker:

This letter is in response to the request by the Federal Reserve Board for comments on draft regulations to implement revisions made in 1980 to the Home Mortgage Disclosure Act (HMDA). The revisions are necessitated by amendments to that Act provided in the Housing and Community Development Act of 1980 (P.L. 96-399).

I am convinced that certain of the Board's proposed regulations go beyond the intent of Congress and do not minimize the regulatory burden imposed by your implementing regulations on the home mortgage industry. Both the original 1977 regulations and your proposed revisions require mortgage lenders to provide more information to enforcement entities than was specified in HMDA by the Congress.

Let me explain:

1. The original 1977 and proposed 1981 regulations require lenders to separately collect and report data on mortgage loans that are both (a) originated and (b) purchased during the applicable reporting period. While HMDA does not require separate reporting, your decision to require it doubles the volume of data which must be made available to the public and to enforcement agencies by mortgage lenders.
2. Your proposed regulations require lenders, for the first time, to collect data on loans intended for use in purchasing a home when that loan is not secured by a first lien. That proposed provision directly contradicts the definition of "mortgage loans" subject to provisions of HMDA.
3. The original 1977 regulations required that lenders make data on mortgage loans available in six categories. Your proposed regulations require data to be made available in

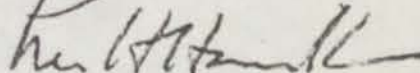


Mr. Paul Volcker  
March 24, 1981  
Page Two

five categories. Yet, HMDA specifies that only four types of data be collected and reported, including total originated and purchased mortgage loans, home improvement loans, mortgage loans on non-owner occupied property, and government insured or guaranteed mortgage loans. The collection of additional data required by your proposed regulations needlessly increases the cost to homeowners and lenders of complying with HMDA.

I urge you to more carefully craft rules designed to implement P.L. 94-200 and P.L. 96-399 to correct these three instances of regulatory law-making which go beyond the mandates of HMDA.

Sincerely,



Lee H. Hamilton  
Chairman, Subcommittee on Economic  
Goals and Intergovernmental Policy



### Savings Bonuses Under the Savings Premium Law

Since 1959, the general public has been able to enjoy bonuses paid on certain contractual or one-time amounts placed as deposits in banks, savings and loan institutions (building societies), or life insurance companies, plus certain loans to and capital stock investments in employers' firms. 2/ The bonuses are 14 percent of cumulated deposits--increased by 2 percent for each dependent child--and are in addition to the other returns on the savings. For individuals, the maximum deposit eligible for these supplements is 800 DM per year, 3/ and the maximum taxable income for eligibility to receive them is 24,000 DM. These limits are doubled for a married couple, whose income cutoff for earning savings bonuses is also increased by 1,800 DM per child. Savings deposited under this plan must be immobilized for six years, if made in lump sums, or one year longer, if made in monthly or quarterly installments under a contractual plan, for the savers to actually receive these supplements. The federal government credits the bonuses to the eligible accounts at the end of these periods.

### Savings Supplements Under the Housebuilding Premium Law

This program is similar to the one described above, including the income and eligible deposit limitations, except that its bonus payments are 18 percent of cumulated deposits, and the sums deposited--with building societies--under it need not be immobilized for specified times. It has been in effect since 1952.

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2/ Since the 1950s, savings have been encouraged through limited tax deductions for savings placed into: life insurance, accounts earmarked for residential construction, accounts of long maturity, and some securities (see below).

3/ The foreign exchange value of the DM is approximately \$0.57.



Savers can withdraw their special accounts if they use the funds for constructing, purchasing, or remodeling a house; these savings, plus bonuses, often form the large downpayments required to buy residences. The cost of the supplements is shared by the federal and state governments.

#### Savings Bonuses Under the Law Promoting Wealth Formation by Employees

Since 1961, employed persons have been able to set aside a certain sum (currently 624 DM) annually, if their incomes are less than the ceiling amounts described above. Such savings, when deposited in banks or savings institutions, or lent to employers, have been eligible to receive bonuses of 30 percent of the total amount saved (40 percent for parents of at least three dependent children) since 1970; they had been free from most employment-related taxes prior to then. The accounts must remain immobilized for seven years for worker to actually receive these supplements. Indeed, many employers go further, by bearing the entire 624 DM yearly payment as an additional form of compensation to their workers under union contracts. Since 1969, bonuses on deposits pursuant to this program have been in addition to any incentives to save under the programs to promote savings and housebuilding.

#### Tax Relief for Savers

Coordinated with the general savings and housebuilding savings plans, in that the tax benefits are not available if such savings bonuses are received, is the long-standing deductibility of savings held with building societies or invested in life insurance from taxable income--subject to certain limits but without an absolute income ceiling. Also, 300 DM of individuals' and 600 DM



of married couples' income from capital is exempted from federal income taxation. Lump sums of 100 or 200 DM, respectively, can be deducted from taxable income derived from capital--as expenses necessary to generate such income. The last two forms of tax relief are available regardless of the amount of savings supplements received.

Assessments of the German Savings Experience in Print

Analyses of the high rate of saving in Germany that are available in English tend to suggest that numerous factors are responsible for it. For example, the attached explanation of saving behavior in West Germany (which CRS neither endorses nor disregards, but rather simply transmits) attributes that country's accumulation of savings to:

- (A) a greater felt need for financial reserves providing protection for contingencies and rainy days, brought about by characteristically pessimistic expectations about the future;
- (B) a perceptible trend toward satiation with consumer goods making it easier for a saving motive of given strength to be translated into behavior;
- (C) a policy of subsidizing mass saving, thus strengthening the instrumentality of saving for medium and long-term accumulation; and
- (D) the ingrained practice of saving in advance of purchasing real estate and consumer durables rather than incurring installment debt, thus making saving highly instrumental for acquiring consumer investment goods. 4/

In such a view, the psychological factors favoring saving--including saving for the purpose of spending the funds on big-ticket consumer purchases in the future--would be reinforced by subsidy and tax programs increasing the reward (interest) for not spending but saving now, so that future consumption could

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4/ Attachment 1, p. 212.



be higher. 5/ Such a result has long been anticipated by economic theory, and appears to have occurred to a certain extent in Germany.

Meanwhile, the rising participation rate of savers in the bonus and tax programs has increased the government contributions to them to the vicinity of 2 percent of the public-sector budget. 6/ Concern over fiscal support of this magnitude, as well as concern that the "small saver" be aided, apparently resulted in limits being placed on the incomes of those eligible for the bonus programs.

We are continuing to develop a research design for a report to be sent to you by early September, which will explore the implications of such proposals for the American economy in general form, and anticipate meeting with you to discuss this design. Meanwhile, please let us know if we can be of further assistance, by calling 287-7593.

Attachment: Strumpel, Burkhard. Saving Behavior in Western Germany and the United States. American Economic Review, May 1975, pp. 210-216.

nd

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5/ In Germany, interest rates on conventional forms of savings have been rather low. The bonus payments represent very large rewards to their recipients, even after taxes and the impact of inflation--which has been lower in Germany than in America--are deducted to show "real" earnings on savings.

6/ For the year 1977, savings promotion expenditures by the federal government were 4.7 billion DM, while tax reductions by it for this purpose were 1.9 billion DM. "Current outlays" by the government were 495 billion DM in 1977. These figures do not include aid to savings by states under the housebuilding premium law. Organization for Economic Co-operation and Development. OECD Economic Surveys: Germany. Paris, 1979. pp. 49, 67.





BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON, D. C. 20551

April 2, 1981

PAUL A. VOLCKER  
CHAIRMAN

The Honorable William Proxmire  
United States Senate  
Washington, D.C. 20510

Dear Senator Proxmire:

This is in further response to your request concerning the legality of the Citi-Shopper customer discount service that is being promoted by Citibank. In my initial response, I indicated that the program did not appear to violate Regulation Q or result in consumer problems, but that I would ask my staff to review this in more detail. This staff review, which was undertaken primarily by the Federal Reserve Bank of New York, was recently completed and I would like to summarize the results for you.

Citi-Shopper is a telephone shopping service for major purchases that is owned by Comp-U-Card of America, Inc., a company that is independent from Citicorp. Through a contract with the Citicorp organization, Citi-Shopper is made available to Citibank's Visa and Master Card cardholders for a subscription fee (currently, 30 days free, and then \$18 for one year, \$27 for two years). Citi-Shopper distributes catalogues to subscribers who then may make purchases using a toll-free number. Subscribers may use their Citibank charge cards to pay for their purchases.

Comp-U-Card services such as Citi-Shopper are made available, often as a fringe benefit, to members of numerous organizations. Often the subscription fee is absorbed by the organization, but many times, as is the case with Citi-Shopper, there is a separate charge to be paid by the member-subscriber.

In the staff's review of this program, it was not able to determine any relationship between Comp-U-Card and Citicorp or its subsidiaries other than a contract with Citicorp Credit Services, Inc., which is a direct subsidiary of Citicorp. Under the contract, Comp-U-Card performs all merchandising functions and offers the service to those who hold cards issued by Citibank (New York), N.A. and who wish to obtain the service. Citicorp Credit Services was formed as a subsidiary by Citicorp under section 4(c)(1) of the Bank Holding Company Act to perform back-office work for the credit card programs of the Citicorp organization. The performance of such bank-office work is a permissible activity for such a subsidiary.



The Honorable William Proxmire  
Page Two

It is my understanding that the Office of the Comptroller of the Currency, the primary regulator of Citibank, regards the bank's interaction with Citi-Shopper as a promotional activity related to credit card use, and is therefore permissible. The Comptroller's Office has determined that Citibank is not in the merchandising business and that Comp-U-Card's advertisements are merely announcements of a service available to Citibank customers.

My staff has further reviewed the Citi-Shopper program to ensure that it does not violate any statutes or regulations from which the Federal Reserve has responsibility. Although that review confirms my earlier report that there are no such violations, the staff indicated that some price comparisons included in recent mailing inserts prepared by Comp-U-Card did not appear to comply with a Federal Trade Commission regulation concerning comparisons of suggested retail prices (16 C.F.R. § 233.3). The staff contacted Citicorp Credit Service to make known these concerns. After reviewing the mailing inserts, Citicorp stated that Comp-U-Card would be instructed to revise these materials. To ensure continued compliance in this regard, Citicorp intends to periodically monitor the mailing inserts from Comp-U-Card.

I hope this response answers any questions you may have regarding the legality of this program.

Sincerely,

S. Paul

LSA:GTS:pjt (#V-390 from 1980)

bcc: Lee Adams  
Gil Schwartz  
Legal Records (2)  
Mrs. Mallardi (2)





BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON, D. C. 20551

APR 2 1981

PAUL A. VOLCKER  
CHAIRMAN

The Honorable Jake Garn  
Chairman  
Committee on Banking, Housing  
and Urban Affairs  
United States Senate  
Washington, D.C. 20510

Dear Chairman Garn:

I am pleased to send you the Board's final version of Regulation Z, implementing the Truth in Lending Simplification and Reform Act. It is the culmination of joint efforts by the Congress and the Board to simplify and improve disclosure requirements and reduce the burdens of compliance. The length of the regulation has been reduced by about 40 percent, and overall we believe it is a substantial improvement.

We have redesignated and consolidated the provisions implementing the Consumer Leasing Act into a separate Regulation M (also enclosed). In the past, these provisions were scattered throughout Regulation Z. Part of the simplification process has focused on reducing the difficulty in using and understanding the regulations, and we believe that combining these leasing rules in a separate regulation -- which has limited applicability -- will improve Regulation Z and also make the leasing rules easier to use by lessors.

There is another reason for our special treatment of the leasing provisions and it relates to the need for statutory change. I would like to urge that an effort be made to simplify the Consumer Leasing Act. The Truth in Lending Simplification and Reform Act simplified disclosure requirements in consumer credit transactions. Although the consumer leasing provisions are part of the new act, they were largely untouched by the simplification effort.

Although we could have simplified the leasing regulation somewhat ourselves, the current statute is an impediment to real reform. We were also discouraged by commenters from revising the regulation in any way that would have required a costly reassessment of procedures and revision of forms without meaningful changes -- particularly if there is a possibility of further statutory amendments that would force them to revise forms and procedures a second time.



We therefore encourage Congress to continue the process begun with the Truth in Lending Simplification and Reform Act by making parallel amendments to the statutory leasing provisions. Such changes would include: (1) highlighting the most important information by segregating it from other disclosures or contract terms; (2) eliminating detailed disclosures that are already covered by lease documents, such as information about maintenance responsibilities and warranties; and (3) encouraging advertising of leases by reducing required advertising disclosures, such as information about purchase options or end-of-lease term liabilities.

You may also want to consider whether to revise the definition of "consumer lease." Currently the consumer leasing requirements do not apply to month-to-month leases that exceed four months. Many consumer commenters on the Regulation Z revision expressed the need for disclosures in these transactions, which now are neither "credit sales" under the Truth in Lending Act nor "consumer leases" under the Leasing Act.

We would be pleased to submit additional specific recommendations in the form of draft legislation. Currently we are asking for the views of our Consumer Advisory Council on the major issues. Once this process is complete, we will be in a position to present concrete proposals for your consideration.

Sincerely,

S/Paul A. Volcker

Enclosure



IDENTICAL LETTERS SENT TO:

The Honorable Harrison A. Williams, Jr.  
United States Senate  
Washington, D.C. 20510

The Honorable John H. Chafee  
United States Senate  
Washington, D.C. 20510

The Honorable Christopher Dodd  
United States Senate  
Washington, D. C. 20510

The Honorable Fernand J. St Germain  
Chairman  
Committee on Banking, Finance  
and Urban Affairs  
House of Representatives  
Washington, D. C. 20515

The Honorable J. William Stanton  
House of Representatives  
Washington, D. C. 20515

The Honorable Thomas B. Evans, Jr.  
House of Representatives  
Washington, D. C. 20515

The Honorable Frank Annunzio  
House of Representatives  
Washington, D. C. 20515

FILE COPY



Mrs. Mallardi  
V-66

April 2, 1981

The Honorable John C. Danforth  
United States Senate  
Washington, D.C. 20510

Dear Senator Danforth:

Thank you for your letter of March 3 regarding correspondence you received from your constituent, Mr. Richard Goins, President, First National Bank of Camdenton, Missouri, on the quality of currency provided by the Federal Reserve Bank of St. Louis.

I am naturally concerned with this report of service and attitude at the Federal Reserve Bank of St. Louis. I hope the situation is only isolated and not representative so far as attitudes are concerned. However, I have been provided with some explanation of the difficulty. The St. Louis Bank apparently had excess inventories of circulated \$10 and \$20 denomination notes which they were using to fill currency orders, before issuing new notes in these denominations. This situation often occurs during the months immediately following the Christmas season when Reserve Banks receive a large amount of circulated currency that was issued during the pre-holiday period. In all instances, the Reserve Banks have attempted to pay out any available stocks of fit currency before issuing new notes. Furnishing only new currency for use in automated teller machines (ATM's) would not be feasible over the long run, considering the rapid growth in ATM use and the inventory required for an ATM.

We are also aware that there has been a general deterioration in the quality of circulating currency over the past few years. Several steps are currently being taken to resolve the situation. One of our major efforts involves the conversion of manual currency processing equipment, to newly developed high-speed currency processing equipment, which automatically performs a comprehensive fitness inspection of each individual note put through the machine. Those notes that are excessively soiled are automatically destroyed during the verification process and newly printed currency is issued in its place.

In tandem with developing this equipment, the Federal Reserve is establishing quality-control standards for the high-speed machines that will allow only currency of an acceptable quality to



The Honorable John C. Danforth  
Page Two

pass through for packaging and redistribution. Currency processed according to these standards has been independently tested by several major commercial banks in order to determine their suitability for ATM's. The first such test was at Chemical Bank in New York, whose ATM's functioned satisfactorily with the fit currency generated by our high-speed equipment operating under the new standards. Further tests of the quality standards were conducted by Manufacturers Hanover of New York and First National Bank of Arizona. High-speed currency furnished for these tests was also found to be satisfactory and confirmed that appropriate sorting settings on the high-speed machinery will provide notes of acceptable quality for ATM use. The St. Louis Reserve Bank is in the process now of converting to the new equipment.

I greatly regret that the operations of Mr. Goins' bank were disrupted by the quality of currency shipped to the bank. I think I can assure you that the situation will continue to improve as the Reserve Bank completes its conversion to high-speed currency processing. I would also hope that Mr. Goins brings his concerns about attitudes and services directly to the attention of officials of the Bank.

Sincerely,

S/Paul A. Volcker

SOA:TEA:PAV:pjt (#V-66)

bcc: Mr. Lawrence K. Roos, President, FRB of St. Louis  
Mr. App  
Mr. Allison  
Mrs. Mallardi (2)



April 2, 1981

The Honorable Charles Pashayan, Jr.  
House of Representatives  
Washington, D.C. 20515

Dear Mr. Pashayan:

Thank you for your letter of March 31 enclosing correspondence from Mr. Gerald C. Collins concerning the reservability of deferred compensation accounts under Regulation D. These accounts are maintained and controlled by employers in accordance with IRS requirements. Because of this, Regulation D currently requires that these funds be regarded as nonpersonal time deposits, subject to a 3 per cent reserve requirement. The Board has asked the staff to review this matter and to present to the Board its recommendations for a possible amendment to Regulation D. Consideration of the staff recommendations is scheduled for April 8.

I will be pleased to keep you advised of the Board's actions in this matter.

Sincerely,

S/Paul A. Volcker

CO:pjt (#V-111)  
bcc: Mrs. Mallardi (2)



CHARLES PASHAYAN, JR.  
17TH DISTRICT, CALIFORNIA

129 CANNON BUILDING  
WASHINGTON, D.C. 20515  
(202) 225-3341



COMMITTEE ON  
INTERIOR AND INSULAR  
AFFAIRS

COMMITTEE ON  
POST OFFICE AND CIVIL  
SERVICE

CONGRESS OF THE UNITED STATES  
HOUSE OF REPRESENTATIVES

March 31, 1981

Honorable Paul A. Volcker  
Chairman  
Federal Reserve System  
Twentieth Street and Constitution Avenue, N.W.  
Washington, D.C. 20551

BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
1981 APR -2 AM 10:49  
RECEIVED  
OFFICE OF THE CHAIRMAN

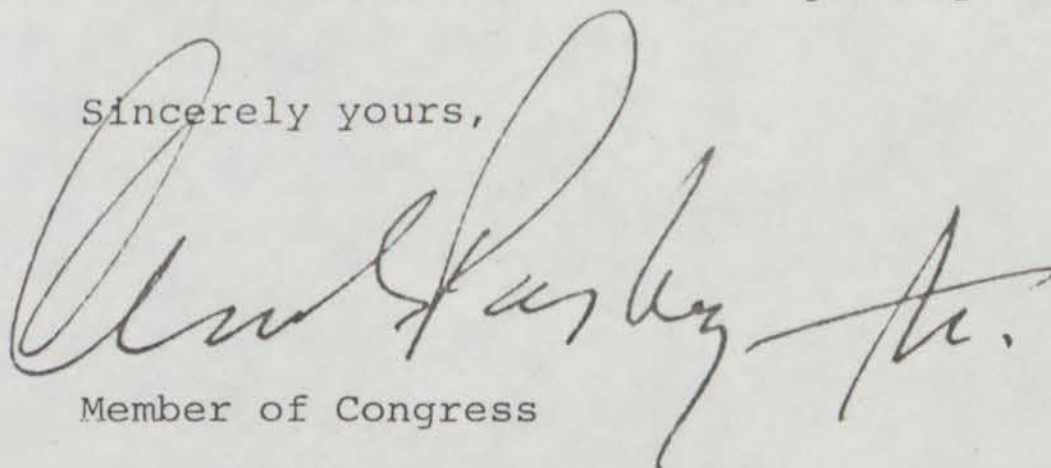
Dear Mr. Chairman:

Enclosed please find a copy of the letter I have received from a constituent, Mr. Gerald C. Collins, in regards to a recent ruling by the Federal Reserve.

I should appreciate your addressing the concerns Mr. Collins has raised.

Your prompt attention to this matter shall be greatly appreciated.

Sincerely yours,



Member of Congress

Enclosure

PLEASE REPLY TO:

☐ WASHINGTON OFFICE

☐ HOME OFFICE, FRESNO COUNTY  
1533 EAST SHIELDS AVENUE, SUITE A  
FRESNO, CALIFORNIA 93704

☐ HOME OFFICE, KINGS COUNTY  
804 NORTH IRWIN  
HANFORD, CALIFORNIA 93230

☐ HOME OFFICE, TULARE COUNTY  
3746 WEST MINERAL KING, SUITE D  
VISALIA, CALIFORNIA 93291





CALIFORNIA FEDERAL

Nation's Largest Federal

March 19, 1981

Representative Charles Pashayan  
1427 Longworth House  
Washington, D. C. 20515

Re: Regulation D

Dear Sir,

Thank you very much for the support you have given the Savings & Loan Industry over the last few years. Most of the legislation that has been passed will benefit our industry and more importantly, allow our industry to meet the savings and housing needs of Americans in the future.

Unfortunately, a recent ruling by the Federal Reserve was contrary to the above. The new Federal Reserve Regulation D has certain provisions that, in effect, will deny the consumer maximum retirement benefits and not allow financial institutions to compete on an even basis for Deferred Compensation (retirement) Accounts.

Specifically, Regulation D classifies Deferred Compensation Accounts as "non-personal" which requires reserves. Other retirement accounts such as IRA and Keough Accounts do not require reserves. This inconsistency in the treatment of retirement accounts does not make sense. Besides, it was our industries understanding during dialogue with the Federal Reserve staff that Reserve Requirements would be waived.

Please write Paul Volcker, Chairman of the Federal Reserve Board, advising him of this oversight and discrepancy in Regulation D. We would like the Regulation changed as described above. If you agree, please encourage Mr. Volcker to do so in your correspondence.

Sincerely,

*Gerald C. Collins*  
Gerald C. Collins  
Vice President  
Regional Manager

GCC/dh

501 West Main Street/Visalia, California 93277/Telephone: 209/732 4554



April 3, 1981

The Honorable John Tower  
United States Senate  
Washington, D. C. 20510

Dear Senator Tower:

Thank you for your letter of March 26 enclosing correspondence you received from Mr. Richard Davis. Mr. Davis is seeking information about the progress of legislation that was introduced to stem the attrition of membership in the Federal Reserve System.

As you are aware, the Depository Institutions Deregulation and Monetary Control Act of 1980 was enacted on March 31, 1980 (Public Law 96-221). The Act is expected to improve monetary control by imposing universal reserve requirements on all depository institutions, including mutual savings banks, savings and loan associations, credit unions, and commercial banks. Such universal reserve requirements were needed to meet the problem of attrition in Federal Reserve membership, which was eroding the effectiveness of monetary policy by lowering the portion of total deposits subject to System reserve requirements. Prior to the passage of the Monetary Control Act, many banks effectively could avoid reserve requirements by not being members of the Federal Reserve System. In addition, all nonbank depository institutions were not subject to reserve requirements. As institutions increasingly gave up membership, the Federal Reserve found it more difficult to maintain an adequate degree of control over the monetary aggregates. Universal reserve requirements resolve the uneven and inequitable level of reserve requirements applicable to similar accounts at various financial institutions. The Act also extends access to Federal Reserve services, such as discount and borrowing privileges, to nonmember depository institutions.

For Mr. Davis' information, I am pleased to enclose copies of Public Law 96-221 and the June 1980 Federal Reserve Bulletin, which contains an article (beginning at page 444) summarizing the legislation.

I hope this information is helpful. Please let me know if I can be of further assistance.

CO:vcd (#V-110)  
bcc: Mrs. Mallardi

Sincerely,

(Signed) Donald J. Winn

Donald J. Winn  
Assistant to the Board

Enclosures



Reply will be prepared by Cong. Liaison Office

JAKE GARN, UTAH, CHAIRMAN

JOHN TOWER, TEX.

JOHN HEINZ, PA.

WILLIAM L. ARMSTRONG, COLO.

RICHARD G. LUGAR, IND.

ALFONSE M. D'AMATO, N.Y.

JOHN H. CHAFFEE, R.I.

HARRISON SCHMITT, N. MEX.

HARRISON A. WILLIAMS, JR., N.J.

WILLIAM PROXMIRE, WIS.

ALAN CRANSTON, CALIF.

DONALD W. RIEGLE, JR., MICH.

PAUL S. SARBANES, MD.

CHRISTOPHER J. DODD, CONN.

ALAN J. DIXON, ILL.

M. DANNY WALL, STAFF DIRECTOR

HOWARD A. MENELL, MINORITY STAFF DIRECTOR AND COUNSEL

## United States Senate

COMMITTEE ON BANKING, HOUSING, AND  
URBAN AFFAIRS

WASHINGTON, D.C. 20510

March 26, 1981

BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
1981 MAR 31 PM 1:04  
RECEIVED  
OFFICE OF THE CHAIRMAN

The Honorable Paul A. Volcker, Chairman  
Board of Governors of the Federal  
Reserve System  
Washington, D. C. 20551


Dear Mr. Volcker:

I am enclosing a copy of a letter I have received from Mr. Richard Davis, [REDACTED]

I shall appreciate receiving a report from you concerning the questions he poses in order that I may properly respond to him.

Thank you for your attention to this matter.

Sincerely,

  
John Tower

enclosure



13  
RICHARD DAVIS, BUILDER  
[REDACTED]  
[REDACTED]  
[REDACTED]  
1 file -  
See [unclear]  
9/13

2 5 81  
1981 FEB -8 PM 12:54

Gentlemen:

Back in February<sup>1980</sup> there was much talk about possibly 600 National Banks dropping their membership in the Federal Banking System. There were at that time bills in the early stages by Henry Reuss, H.R.7, by Proxmire, S.85, and John Tower, S.353.

Gentlemen, can you please give me an update on these three bills and any other pertinent information related to the status of our banking system.

At that time according to U.S. News & World Report Fed. Reserve members participating had dropped to 78% and falling. What is that percentage today? What has been accomplished in retarding that decline?

Also, there was at that time legislation which would require all banks to join the Fed. banking system. Please update me on this.

Thank you.

*Richard Davis*

Sincerely:



*Mrs. Mallardi*

April 3, 1981

The Honorable Gregory W. Carman  
House of Representatives  
Washington, D.C. 20515

Dear Mr. Carman:

Thank you for your March 25 letter reporting on the financial condition of thrift institutions in the State of New York. As you might expect, the Federal Reserve Board, the Federal Deposit Insurance Corporation and the Federal Home Loan Bank Board have been closely monitoring the financial condition of the thrift industry for some time.

In the second half of 1980 the thrift industry generally succeeded in attracting sizable deposit flows, but this effort required the payment of substantially higher deposit rates as the period progressed. As a result of their large portfolios of fixed-rate long-term mortgages, the higher deposit costs sharply reduced their earnings and by late in the year many individual institutions were experiencing negative earnings. Such earnings pressures have continued in the early months of this year, although the most recent declines in interest rates have tended to ease this pressure somewhat.

The thrifts have allocated a large portion of their cash flow to liquid assets so that their problems has been one of earnings and capital rather than liquidity. However, in the last couple of months deposit flows have slowed. If continued erosion in deposit growth should place particular thrift institutions in a serious liquidity bind that cannot be ameliorated through borrowing from usual sources, the Federal Reserve is, of course, prepared to provide needed liquidity through its discount window--on a fairly extended basis if necessary.

The Federal Reserve, the federal agencies responsible for supervising the thrift industry, and the Administration have been reviewing measures that might be taken to assist depository institutions whose capital positions are being pressed by losses resulting from the mismatch between their asset returns and liability costs. It is my hope that our review will soon result in proposals to the Congress for legislation that would facilitate capital assistance to otherwise viable thrift institutions.

I hope these comments are useful.

Sincerely,

S/Paul A. Volcker

ECettin:PMKeir/kt  
V-109



April 3, 1981

The Honorable Wyche Fowler, Jr.  
House of Representatives  
Washington, D.C. 20515

Dear Mr. Fowler:

Thank you for your letter of March 23, referencing your constituent's difficulty in obtaining a \$1,000 Federal Reserve note for a sales promotion.

Let me emphasize that individuals are not restricted by regulation or any provision of law from obtaining \$1,000 notes that are still part of our nation's circulating currency. There is not, however, an abundant supply of these notes since the \$100 bill is the largest denomination currently printed by the Bureau of Engraving and Printing (BEP), and the Federal Reserve System is destroying rather than reissuing any note of \$500 or above that it receives from the commercial banking system.

This reduced availability of large denomination notes stems from a joint decision by the Federal Reserve and the Treasury Department--based on costs to the taxpayer--to discontinue the issuance of Federal Reserve notes of the \$500, \$1,000, \$5,000 and \$10,000 denominations as of July 1969. The rationale for this decision was that the demand for these large denomination notes, which had been declining sharply over two decades, had become insufficient to warrant the additional production and storage costs associated with their continued issuance.

Large denomination notes were first authorized primarily for interbank transactions by an amendment to the Federal Reserve Act in 1918. Shrinking demand for these notes prompted the decision to discontinue their printing in 1946. Even with this decision, the supply that was on hand in 1946 did not diminish to the point where continued circulation would have required additional printing until 23 years later, in 1969. Surveys at that time indicated that large dollar transactions could be conducted effectively with checks or \$100 notes. Today, our electronic funds transfer system is the principal means by which the banking industry effects large transactions, and we continue to believe that the demand for currency in denominations larger than \$100 would not justify the substantial costs associated with its issuance.



The Honorable Wyche Fowler, Jr.  
Page Two

Although a majority of the \$500 and higher denomination notes have been removed from circulation over the years, some do still circulate. Your constituent may be able tooobtain a \$1,000 note by contacting financial institutions in his or her area, especially the larger ones, and asking them to set aside any \$1,000 note they may receive in the course of business.

I hope this information is useful to your constituent.

Sincerely,

S/Paul A. Volcker

JHE:TEA:pjt (#V-96)

bcc: Mr. Epps  
Mr. Allison  
Mrs. Mallardi (2)



April 6, 1981

The Honorable Paula Hawkins  
United States Senator  
P. O. Box 2000  
Winter Park, Florida 32790

Dear Senator Hawkins:

Thank you for your letter of March 31 requesting comment on a letter you received from Mr. Harry Z. Rosenberg, who objects to the practice he has observed of banks delaying the availability of funds received as a result of wire transfers and other financial transactions. The Federal Reserve Banks offer a wire transfer service that allows depository institutions holding balances with a Reserve Bank to transfer funds to the account of any other depository institution holding balances with a Reserve Bank. The Federal Reserve regulation governing this activity requires depository institutions receiving funds by wire transfer to make them promptly available to these customers. However, there are a number of other funds transfer systems operated by the private sector. These networks, which are not regulated, are not governed by the Federal Reserve regulations.

We are not aware of any intentional actions on the part of banks to delay their customer transactions. With more than 14,000 commercial banking institutions in the nation to serve the needs of business, we would expect competition among these banks to provide the incentive to handle customer transactions on a timely basis.

Delays in delivery of a transfer can occur because of human error and machine failure. In addition, the volume of transactions has increased significantly during the past couple of years, which can compound the problem of delays.

We would be pleased to assist Mr. Rosenberg in investigating any specific instances in which he believes Federal Reserve wire transfers were delayed by a bank.

I hope this information is helpful. Please let me know if I can be of further assistance.

Sincerely,

(LSM:)CO:pjt (#V-115)  
bcc: Mrs. Mallardi ✓

15 /  
William R. Maloni  
Special Assistant to the Board



April 7, 1981

The Honorable Carroll Hubbard  
House of Representatives  
Washington, D. C. 20515

Dear Mr. Hubbard:

Thank you for your letter of March 17 recommending Mr. Robert M. Duncan for membership on the Board's Consumer Advisory Council. We would be pleased to receive additional information from you and others in support of Mr. Duncan's nomination, including any special knowledge, interests, or experience that he has relating to consumer credit. This information should be sent to Dolores S. Smith, Assistant Director, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, Washington, D. C. 20551. Our next selection of new Council members will take place sometime this fall, to fill the positions of individuals whose terms expire in December 1981.

I appreciate your taking the time to call our attention to qualified individuals who could contribute to the Council's work. We make a special effort to achieve a geographic distribution within the Council, as well as a balance in representation among various segments of the credit industry and consumer interests. Our task is not an easy one, given the small number of positions (usually 8 to 10) to be filled each year and the high qualifications of many of the nominees.

Again, thank you for your interest.

Sincerely,

S/Paul A. Vocker

AMB:DSS:WRM:vcd (#V-93)

bcc: Ms. Bray (w/copy of incoming)  
Ms. Smith  
Mrs. Mallardi (2) ✓





BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON, D. C. 20551

April 8, 1981

PAUL A. VOLCKER  
CHAIRMAN

The Honorable Jake Garn  
Chairman  
Committee on Banking,  
Housing and Urban Affairs  
United States Senate  
Washington, D.C. 20510

Dear Mr. Chairman:

We are forwarding a copy of the report made by Arthur Andersen & Co., Certified Public Accountants, covering the audit of the financial statements and records of the Board of Governors of the Federal Reserve System for the year ended December 31, 1980 and a copy of the Board's 1980 Budget Performance Report.

A copy of each of these has also been provided the General Accounting Office.

Sincerely,

*Paul A. Volcker*

Enclosures





BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON, D. C. 20551

April 8, 1981

PAUL A. VOLCKER  
CHAIRMAN

The Honorable Fernand J. St Germain  
Chairman  
Committee on Banking,  
Finance and Urban Affairs  
House of Representatives  
Washington, D.C. 20510

Dear Mr. Chairman:

We are forwarding a copy of the report made by Arthur Andersen & Co., Certified Public Accountants, covering the audit of the financial statements and records of the Board of Governors of the Federal Reserve System for the year ended December 31, 1980 and a copy of the Board's 1980 Budget Performance Report.

A copy of each of these has also been provided the General Accounting Office.

Sincerely,

*Paul A. Volcker*

Enclosures



April 9, 1981

The Honorable John C. Danforth  
United States Senate  
Washington, D. C. 20510

Dear Senator:

I have your letter about KMOX in  
St. Louis. I haven't heard anything  
from them, but we'll try to work something  
out when I do.

Sincerely,

PAV:ccm





BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON, D. C. 20551

April 9, 1981

PAUL A. VOLCKER  
CHAIRMAN

The Honorable Paul Laxalt  
United States Senate  
Washington, D. C. 20510

Dear Senator Laxalt:

Thank you for your letter of March 18 requesting comment on the enclosed statement of Mr. W. C. Smith supporting bills that would exempt from federal taxation the interest income on time and savings deposits used to support residential mortgage lending.

Under <sup>current</sup> ~~this~~ legislation, taxpayers will be able to exclude an additional \$200 in interest and dividend earnings (\$400 on joint returns) from their 1981 and 1982 taxable income. I am concerned that high marginal tax rates do reduce the incentive to save. However, I am not sure the proposed legislation is the best way to correct the problem.

While the Federal Reserve Board is deeply committed to the objective of maintaining an adequate flow of funds to finance housing activity, we would be reluctant to support measures exempting from taxation interest income on deposits supporting mortgage lending. The degree to which such a policy would significantly increase the availability of mortgage credit or reduce its cost is not clear. Moreover, even if thrift institutions experienced sizable new inflows--or significant cost reductions--it is not altogether clear that mortgage rates would decline appreciably. As mortgage rates began to decrease, other lenders in the mortgage market--such as life insurance companies or pension funds--would shift to other long-term instruments offering a relatively more attractive yield. The movement of these investors out of mortgages would tend to offset the initial downward pressure on mortgage rates.

Absent a sizable reduction in mortgage rates, savings incentives similar to those supported by Mr. Smith are unlikely to stimulate residential construction, and the revenue loss from tax exemption will widen the federal deficit. Thus, I



The Honorable Paul Laxalt  
Page Two

believe that an exemption of interest income could represent a significant departure from current policy efforts to trim the federal budget deficit, and one that potentially could be quite inflationary.

The exceptionally high interest rates that we have experienced in recent years are the by-product of a stubbornly high rate of inflation. In a very real sense inflation is the root cause of the problems currently being faced by the thrift industry and the mortgage market. Only when inflationary pressures are brought under control--through diligent application of prudent monetary policy and budgetary discipline--will mortgage rates be reduced appreciably.

I hope you will find these comments useful.

Sincerely,

S/Paul A. Volcker

MM:EM:DLK:JLK:RS:vcd (#163)

bcc: Messrs. Moran, McKelvey, Kohn and Kichline  
Mrs. Mallardi (2)



*Mrs. Mallardi*  
*(V-106)*

April 9, 1981

The Honorable Lee H. Hamilton  
Chairman  
Subcommittee on Economic Goals  
and Intergovernmental Policy  
Joint Economic Committee  
Washington, D.C. 20510

Dear Chairman Hamilton:

Thank you for your comment letter of March 24 concerning the Board's proposal to implement the Home Mortgage Disclosure Act (HMDA) amendments of 1980.

You note that the original and the proposed regulation both require reporting of data on originated mortgage loans separately from data on purchased mortgage loans. In your opinion, the statute does not require separate reporting. The Board believes that both the language of the Act and the 1975 legislative history support the view that Congress intended originations and purchased loans to be reported separately. The separate reporting requirement may in fact be easier for depository institutions to report separately than to have to aggregate the origination and purchase data for each census tract. However, we will give this issue careful consideration in adopting the final regulation.

You also referred to the proposed requirement for the collection of data on purchase money mortgage loans that are secured by junior liens. The staff tells me that the definition of "mortgage loan" in the Act is rather broad, and appears to cover any loans secured by residential real estate, not only first lien mortgage loans. However, there may be good policy reasons for covering only first lien loans, and the Board will certainly consider this matter carefully in light of the comments on the proposed changes.

Finally, you note that the Act requires loan data to be collected and reported according to four categories, while the proposed regulations would require five categories. The difference basically lies in the fact that the regulation requires a break-out of loans on multi-family property. It is believed that there is some value in treating one-to-four family dwellings separately from multi-family property; however, the Board will give further consideration to this matter.



The Honorable Lee H. Hamilton  
Page Two

Let me also assure you that the Board is keenly aware of the need to minimize regulatory burdens, and that we are attempting to do so in this case--while at the same time carrying out the responsibility to implement this statute. Thank you again for your comments on the Board's proposal.

Sincerely,

S/Paul A. Volcker

DSS:RS:pjt (#V106)  
bcc: Dolores Smith  
Mrs. Mallardi (2)





BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON, D. C. 20551

April 9, 1981

PAUL A. VOLCKER  
CHAIRMAN

The Honorable Bill Green  
House of Representatives  
Washington, D.C. 20515

Dear Bill:

I appreciated receiving your recent letter indicating why you feel that H. R. 1397 will prove effective in encouraging household savings and is preferable to an approach based on tax incentives. The materials from the Congressional Research Service (CRS) and Wall Street Journal, which you were kind enough to enclose with your letter, were also useful. You asked for my views on how a savings subsidy could be structured to minimize the possibility that households, in order to obtain added returns, would simply shift funds from an unsubsidized asset form into a subsidized form. You also asked for suggestions about savings vehicles that would conflict with the DIDC's mandate to deregulate interest rates.

After having carefully reviewed your letter and the materials which accompanied it, I am still concerned that the additional savings which implementation of your proposal might generate may not be sufficient to warrant the added Treasury outlays. Admittedly, we are all operating with very limited information in this area. It may be true, as you say, that focusing on moderate income groups will prove an effective approach to promoting savings in the United States. But as the CRS study by Dr. Jackson indicates, it is not possible to know with certainty how any income group would respond to an additional inducement to save.

There is also a large area of uncertainty about how applicable the German experience may be for the United States. I do not question the judgment of Dr. Lambdorff, with whom you spoke recently, that the subsidies offered in his country have promoted savings. However, as the discussion by the CRS indicates, there are a number of other important factors that have had a strong influence on the savings propensities of the German people, and it is impossible to disentangle the relative effects of each.

As for your point that the proposed subsidy will not affect the near-term budget position of the Federal Government, I am of two minds. I very much agree that it is desirable to



minimize the Treasury's deficits over the critical period of the next few years. If we are to make substantial inroads into the current inflation psychology, we must follow policies that convince the public that the federal budget will be brought into balance as soon as it is feasible to do so. However, I would still be worried about a program which has little or no impact on the immediate budget but commits the Federal Government to large expenditures in the future. To an important extent, it is just such programs that are responsible for the unacceptably rapid growth of federal outlays in recent years. Nor, am I sure that programs that have a deferred impact on the budget will necessarily minimize the reaction of the private sector. After all, participants in the financial markets are acutely aware of the governmental programs that have led to our current budget difficulties and would likely respond to the prospective effects of a new program about as much as to its current effects.

In addition to the general issue of whether total savings of the household sector would be increased by a subsidy program, there is the additional question of the extent to which households will shift assets from an unsubsidized to a subsidized form and/or rechannel savings flows in this way. To the extent such substitutions do occur, of course, the cost of a subsidy program will be increased relative to the amount of additional savings generated. I am afraid that I have no practical answer to your question as to how a program might be established to effectively target incentives exclusively to new savings flows. There is no simple way of telling the extent to which changes in household holdings of a specific asset reflect an added increment of savings rather than a shifting of funds from other assets.

With regard to the creation of a savings vehicle for subsidized savings accounts that would not interfere with the DIDC's deregulation mandate, the approach currently used for IRAs and Keogh plans merits examination. In particular, individual "subsidy" accounts could be established at banks and thrift institutions and, perhaps, other financial institutions. The custodians of these accounts could be free to invest deposited funds in existing financial instruments at market determined rates of return. They could also be charged with certifying to the Treasury when deposits have remained in the account for the required time period and are eligible for a subsidy.

In case I seem too negative, let me emphasize again that I share your concerns about the current level of saving and capital formation. I also agree that providing incentives



The Honorable Bill Green  
Page Three

which increase the after-tax rate of return available to savers will tend to stimulate private savings. However, I am not certain that cost-effective programs can be designed to provide such incentives. Whatever the final approach taken to encourage savings, it is important that it be accompanied by corresponding reductions in the federal outlays. Otherwise, the increased savings generated would of necessity end up financing the Treasury's increased deficit. And, at the same time, public confidence in the government's resolve to get its financial house in order could be seriously eroded.

Thanks again for giving me this further opportunity to comment on your savings proposal. I hope these comments will be helpful.

Sincerely,

S/ Paul

WR:FMS:JLK:RS:vcd (V-103)

bcc: Messrs. Kichline, Struble, Ramm  
Mrs. Mallardi (2)



April 10, 1981

The Honorable Walter E. Fauntroy  
Chairman  
Subcommittee on Domestic Monetary Policy  
Committee on Banking, Finance and  
Urban Affairs  
House of Representatives  
Washington, D.C. 20515

Dear Chairman Fauntroy:

I very much appreciate your letter of April 1. I too believe that the discussion of our mutual concerns in the context of the informal gathering last week was most worthwhile, and I know that the other members of the Board and the Reserve Bank Presidents also share that view and were very pleased to be able to meet with you and the other Subcommittee members. I hope that we can do something similar on other occasions.

With respect to your suggestion of a meeting with the members of the Congressional Black Caucus, I would welcome the opportunity to meet with the members of the Caucus for an informal discussion whenever that could be arranged. If your staff would contact Don Winn on 452-3457, we will be pleased to work out the details.

Sincerely,

S. Paul

DJW:pjt (#V-113)  
bcc: Mrs. Mallardi (2)



SEASONAL ADJUSTMENT  
OF THE  
MONETARY AGGREGATES

A Committee Report

January 1981





United States  
of America

# Congressional Record

PROCEEDINGS AND DEBATES OF THE 97<sup>th</sup> CONGRESS, FIRST SESSION

Vol. 127

WASHINGTON, FRIDAY, JANUARY 23, 1981

No. 13

## SAVINGS AND RETIREMENT INCOME INCENTIVE ACT OF 1981

Mr. MOORE. Mr. Speaker, as individual taxes climb, disposable income dwindles and personal savings become a necessary income supplement to meet costs imposed by inflation instead of an investment reserve to which regular deposits were once made. As a result, personal savings rates in this Nation are pitifully low especially when compared to those of other major industrial nations.

On the average, Japanese workers save four times as much as we do. West German savings are triple our rate, and Canadians save twice our level. In the last decade our savings rates have fallen while each of theirs has risen.

It is no mystery why Americans save so little today or why Japan, West Germany, Canada, and other countries have a comparative abundance of savings capital upon which to draw for economic expansion and competition with us.

In Japan interest earned on the first \$23,000 of individual savings is tax free. In West Germany, families with children and with low- to moderate-incomes are given sufficient tax cuts for long-term saving to cause 94 percent of blue collar workers to establish and regularly add to their savings accounts. In Canada, employee contributions to employer-sponsored pension plans are tax deferred in amounts up to \$3,300 per year and individuals having their own retirement plans can defer taxes on up to \$5,500 in annual additions. This is by no means an inclusive list of their savings incentive or nations offering them.

By comparison, we are pikers in the savings game and, for this reason, we are losing it. Until language I initiated in the House won approval as part of the Windfall Profit Tax Act approved in the last Congress, this Nation fully taxed every dollar of interest income received by individuals. The \$400 maximum annual exclusion granted last year for interest and dividend income in 1981 and 1982 tax years appears paltry when compared to savings incentives in Japan, West Germany, or Canada, but it is a step in the right direction and one that should have been taken long ago.

Much more needs to be done to give a favorable real after-tax rate of return on savings to track or hopefully stay ahead of inflation. Foreign experience shows savings can best be built by reducing the tax imposed on it. Our tax on savings is particularly onerous as interest income is taxed at the highest rate an individual must pay and commonly it puts a taxpayer into a higher tax bracket when added atop earned income as our tax policy instructs.

To counter this built-in tax bias against savings, Senator JOHN CHAFEE and I are jointly introducing a bill to build upon the present interest and dividend exclusion and expand individual retirement account eligibility and benefits. Our Savings and Retirement Income Incentive Act of 1981 is a natural extension of guidance given by the Senate Finance Committee late last year in its omnibus tax cut bill. It embraces desired objectives of simple yet

functional design, tax adjustment to account for interest and dividend income damage caused by inflation, self-reliance in retirement income management, first-time home ownership, new savings formation, and vocational or college education for the account holder's children. It has won approval by more than 25 national organizations representing investment and financial communities, the Nation's largest retirement organizations, and national military organizations. Initial estimates put its static revenue cost at some \$4 billion in the first year with savings formation encouraged by its terms giving an early cost recovery. Econometric tests are underway. In view of recent surges in personal debt growth, and record low rates of personal savings, it is extremely timely. It also only rewards retirement savings beyond activity already provided under mandatory employer-sponsored plans.

Many notions on savings formation are being offered these days. Senator CHAFEE, who serves as chairman of the Subcommittee on Savings, Pensions, and Investment Policy, and I are convinced this bill gets highest marks when all objective tests are applied, especially in terms of the wide range of worthy purposes served on an equal basis and at a reasonable cost.

For this reason, we have recommended its inclusion in the forthcoming tax cut recommendations of the administration and Senator CHAFEE intends to begin hearings on it at an early date.

A summary of the bill, a list of organizations supporting or in most cases endorsing it, as well as the measures full text follow:

### BILL SUMMARY

The "Savings and Retirement Income Incentive Act of 1981" is designed to increase the incentives for individual savings and investment in the following ways:

(1) The bill makes permanent the exclusion from tax of the first \$200 (\$400 on a joint return) of dividend and interest income and increases that amount to \$500 (\$1,000 on a joint return) when an individual or spouse attains the age of 65.

(2) The bill permits the use of individual retirement accounts (IRA's) by employees, including government employees and military personnel, who are covered by employer-sponsored retirement plans and increases the maximum allowable deductible contributions to these accounts from \$1,500 per year under existing law to \$2,000 per year or the total amount of the employee's earned income, whichever is less.

(3) In lieu of a contribution to a separate IRA, the bill permits an employee to make a \$2,000 per year tax-deductible, voluntary contribution to his employer-sponsored retirement plan, if the plan so permits.

(4) The bill permits additional voluntary non-deductible contributions of \$2,000 per year plus an additional \$3,000 over the employee's lifetime to either an IRA or an employer-sponsored plan thereby increasing the size of the account so that the expense of managing and promoting such savings plans will be more easily absorbed. Tax is deferred on earnings from all moneys contributed to the account so that the employee's total savings are also enhanced by such contributions. This provision is similar to existing law regarding corporate pension plans and Keogh plans for the self-employed. Thus, for example, in one year an individual could make a deductible contribution to an IRA of \$2,000 and a non-deductible contribution of \$10,000; thereafter, he could make annually a deductible contribution of \$2,000 and a non-deductible contribution of \$2,000.

(5) Finally, the bill permits an employee to withdraw without penalty up to \$10,000

from the account in order to purchase a first home or to pay for the higher education of his children. (The amounts so withdrawn are subject to income tax in the year of withdrawal.) This provision will make IRA's attractive to younger employees who are hesitant to invest funds for retirement savings which may still be needed for major family commitments.

### ENDORSEMENTS OR STATEMENTS OF SUPPORT

American Association of Retired Persons.  
National Retired Teachers Association.  
National Association of Retired Federal Employees.  
Merrill Lynch, Pierce, Fenner & Smith, Inc.  
National Association of Federal Credit Unions.  
Credit Union National Association, Inc.  
Investment Company Institute.  
U.S. League of Savings Associations.  
National Savings and Loan League.  
National Consumer Finance Association.  
National Association of Mutual Savings Banks.  
Independent Bankers Association.  
Chief Warrant and Warrant Officers Association, U.S. Coast Guard.  
U.S. Army Warrant Officers Association.  
American Security Council.  
Reserve Enlisted Association.  
National Association for Uniformed Services.  
Veterans of Foreign Wars of the United States.  
Marine Corps League.  
Non Commissioned Officers Association.  
Disabled Officers Association.  
Association of the United States Army.  
Navy League of the United States.  
Army Mutual Aid Association.  
Retired Officers Association.  
Military of the World Wars.

H.R. 1250

A bill to amend the Internal Revenue Code of 1954 to increase the allowable contributions to individual retirement plans and to allow employees a deduction for savings contributions to employer retirement plans or to individual retirement accounts

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

### SECTION 1. SHORT TITLE.

This Act may be cited as the "Savings and Retirement Income Incentive Act of 1981".

### SEC. 2. AMENDMENTS TO MAKE PERMANENT CURRENT INTEREST AND DIVIDEND EXCLUSION AND TO INCREASE SUCH EXCLUSIONS FOR PERSONS OVER AGE 65.

(a) Section 404(c) of the Crude Oil Windfall Profit Tax Act of 1980 is amended to read as follows:

"(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to taxable years beginning after December 31, 1980."

(b) Paragraph (1) of Section 116(b) of the Internal Revenue Code, as amended by Section 404(a) of the Crude Oil Windfall Profit Tax of 1980, is amended to read as follows:

"(1) MAXIMUM DOLLAR AMOUNT.—  
"(A) GENERAL EXCLUSION.—Except as provided in subparagraph (B), the aggregate amount excluded under subsection (A) for any taxable year shall not exceed \$200 (\$400 in the case of a joint return under section 6013).

"(B) In the case of an individual who has attained age 65 before the close of the taxable year or who is married as of the close of the taxable year to an individual who has attained age 65 before the close of the taxable year, the aggregate amount excluded under subsection (a) for any taxable year shall not exceed \$500 (\$1,000 in the case of a joint return under section 6013)."

### SEC. 3. INCREASE IN PERMISSIBLE CONTRIBUTIONS TO INDIVIDUAL RETIREMENT ACCOUNTS.

(a) Section 219(b) of the Internal Revenue Code of 1954 (relating to retirement savings) is amended—

(1) by deleting the words "an amount equal to" from paragraph (1), by striking



on "15 percent" wherever it appears and inserting in lieu thereof "the amounts", and by striking out "1,500" wherever it appears and inserting in lieu thereof "\$2,000".

(2) by deleting paragraph (2) and redesignating paragraphs (3) through (7) as paragraphs (2) through (6).

(b) Section 4973(b) of such Code is amended to read as follows:

"(b) EXCESS CONTRIBUTIONS.—For purposes of this section, in the case of individual retirement accounts, individual retirement annuities, or bonds, the term 'excess contributions' means the sum of—

"(1) the excess (if any) of—

"(A) the amount contributed for the taxable year to the accounts or for the annuities or bonds (other than a rollover contribution described in section 402(a)(5), 403(a)(4), 403(b)(8), 408(d)(3), or 409(b)(3)(c)), over

"(B) \$2,000 plus the amount allowable as a deduction under section 219 for such contributions, and

"(2) the amount determined under this subsection for the preceding taxable year, reduced (but not below zero) by the sum of—

"(A) the distributions out of the account for the taxable year which were included in the gross income of the payee under section 408(d)(1),

"(B) the distributions out of the account for the taxable year to which section 408(d)(5) applies, and

"(C) the excess (if any) of—

"(i) \$2,000 plus the maximum amount allowable as a deduction under section 219 for the taxable year over

"(ii) the amount contributed (determined without regard to section 219(c)(5)) to the accounts or for the annuities or bonds for the taxable year.

The amount determined under the preceding sentence shall be reduced (but not below zero) by the excess (if any) of 8,000 over the aggregate of the amounts contributed for each prior taxable year in excess of the sum of \$2,000 and the amount allowable as a deduction under section 219 of such prior taxable year.

(c) Section 408 of such Code is amended—

(1) by striking out "\$1,500" wherever it appears and inserting in lieu thereof "\$4,000".

(2) by adding to paragraph (1) of subsection (a) the following sentence: "For purposes of the preceding sentence if contributions for any taxable year exceed \$4,000 on behalf of any individual, they shall not be taken into account except to the extent that such excess contributions, when aggregated with any similar excess contributions for prior taxable years, exceed \$8,000."

(3) by amending paragraphs (1) and (2) of subsection (d) to read as follows:

"(1) IN GENERAL.—Except as otherwise provided in this subsection, any amount or annuity contract paid or distributed out of an individual retirement account or under an individual retirement annuity to any distributee shall be taxable to him in the year in which so distributed under section 72 (relating to annuities).

"(2) COMPUTATION OF EMPLOYEES' CONTRIBUTIONS.—For purposes of this paragraph and section 72, any amounts for which a deduction is allowed under section 219 shall be treated as an employer contribution."

(4) by deleting the words "or 220" from paragraphs (4) and (5) of subsection (d) wherever they appear.

(5) by amending subsection (f)—

(A) by inserting before the period at the end of paragraph (1) thereof "unless such distribution is a qualified withdrawal as defined in paragraph (4)", and

(B) by adding at the end thereof new paragraphs (4) and (5) to read as follows:

"(4) QUALIFIED WITHDRAWAL.—Paragraphs (1) and (2) shall not apply to any withdrawal during a taxable year in which the individual has made no prior qualified withdrawals—

"(A) which is used—

"(i) to pay the qualified educational expenses of a child of the individual for whose benefit the trust is maintained, or

"(ii) in connection with the purchase of the first dwelling purchased by the individual for whose benefit the account is maintained which constitutes his principal residence,

"(B) which is not less than \$2,000, but which when aggregated with all qualified withdrawals in prior taxable years does not exceed \$10,000, and

"(C) which will not cause the fair market value of the account immediately after the withdrawal to be less than \$2,000.

"(5) DEFINITIONS.—

"(A) QUALIFIED EDUCATIONAL EXPENSE.—The term 'qualified educational expense' means—

"(i) tuition and fees required for the enrollment or attendance of a student at an eligible educational institution,

"(ii) fees, books, supplies, and equipment

required for courses of instruction at an eligible educational institution, and

"(iii) a reasonable allowance for meals and lodging.

"(B) ELIGIBLE EDUCATIONAL INSTITUTION.—The term 'eligible educational institution' means—

"(i) an institution of higher education, or

"(ii) a vocational school.

"(C) INSTITUTION OF HIGHER EDUCATION.—The term 'institution of higher education' means the institutions described in section 1201(a) or 491(b) of the Higher Education Act of 1965.

"(D) VOCATIONAL SCHOOL.—The term 'vocational school' means an area vocational education school as defined in section 195(2) of the Vocational Education Act of 1963 which is in any State (as defined in section 195(8) of such Act.)"

"(d) Section 72 of the Internal Revenue Code of 1954 (relating to annuities; certain proceeds of endowments and life insurance contracts) is amended by redesignating subsection (o) as subsection (p) and by inserting after subsection (n) the following new subsection:

"(o) TREATMENT OF DISTRIBUTIONS FROM INDIVIDUAL RETIREMENT ACCOUNTS.—For purposes of subsections (c)(1)(A) and (e)(1)(B), any contribution made by an individual to an individual retirement account which is allowed as a deduction under section 219 shall be treated as an amount contributed by an employer which is not includible in the gross income of such employee."

(e) Section 2039 of the Internal Revenue Code of 1954 (relating to the Estate Tax) is amended by repealing subsection (e) thereof and redesignating subsection (f) as subsection (e).

(f) Section 2517(b) of the Internal Revenue Code of 1954 (relating to the gift tax) is amended by striking the parenthetical phrase "(other than paragraphs (4) and (5))" and substituting "(other than paragraph (4))."

SEC. 4. ALLOWANCE OF RETIREMENT SAVINGS DEDUCTION.

Part VII of subchapter B of chapter 1 of such Code (relating to additional itemized deductions of individuals) is amended by repealing section 220 and by substituting therefor the following new section:

"SEC. 220. DEDUCTION FOR CERTAIN EMPLOYEE RETIREMENT SAVINGS CONTRIBUTIONS.

"(a) GENERAL RULE.—In the case of an eligible employee, described in subsection (c)(2), there shall be allowed as a deduction the qualified retirement savings contributions of such individual for the taxable year.

"(b) LIMITATIONS AND RESTRICTIONS.—

"(1) MAXIMUM DEDUCTION.—The amount allowable as a deduction under subsection (a) to an eligible employee for any taxable year may not exceed the lesser of—

"(A) the amount of the compensation includible in the eligible employee's gross income for such taxable year, or

"(B) \$2,000.

"(2) ALTERNATIVE DEDUCTION.—No deduction shall be allowed under subsection (a) for the taxable year if a deduction is allowed under section 219 for the taxable year.

"(c) DEFINITIONS AND SPECIAL RULES.—

"(1) QUALIFIED RETIREMENT SAVINGS CONTRIBUTION.—For purposes of this section, the term 'qualified retirement savings contribution' means any contribution in cash, other than a mandatory contribution, made by an individual as an employee to or under—

"(A) a plan described in section 401(2) which includes a trust exempt from tax under section 501(a),

"(B) an annuity plan described in section 403(a),

"(C) a qualified bond purchase plan described in section 405(a), or

"(D) a plan described in section 805(d)(3)".

"(2) ELIGIBLE EMPLOYEE.—For purposes of this section, the term 'eligible employee' means any individual who is an active participant for any part of the taxable year in a plan described in paragraph (1).

"(3) RECONTRIBUTED AMOUNTS.—No deduction allowed under this section with respect to a rollover contribution described in section 402(a)(5), 403(a)(4), 403(b)(8), 408(d)(3), or 409(b)(3)(C).

"(4) AMOUNTS CONTRIBUTED TO AN INSURANCE CONTRACT.—No deduction shall be allowed under this section for that portion of the amounts paid which are properly allocable, under regulations prescribed by the Secretary, to the cost of life insurance.

"(5) MARRIED INDIVIDUALS.—In the case of an individual who is married (as determined under section 143(a)), the maximum deduction under subsection (b) shall be computed separately for each individual, and this section shall be applied without regard to any community property laws.

"(6) TIME WHEN CONTRIBUTIONS DEEMED MADE.—For purposes of this section, a taxpayer shall be deemed to have made a contribution on the last day of the preceding taxable year if the contribution is made on account of such taxable year and is made not later than the time prescribed by law for filing the return for such taxable year (including extensions thereof).

"(7) COMPENSATION.—For purposes of this section, the term 'compensation' includes earned income as defined in section 401(c)(2).

"(8) MANDATORY CONTRIBUTIONS.—For purposes of this section, the term 'mandatory contributions' means amounts contributed to the plan by the employee which are required as a condition of employment, as a condition of participation in such plan, or as a condition of obtaining benefits under the plan attributable to employer contributions.

"(d) SIMPLIFIED REPORTS.—The Secretary shall issue regulations which prescribe the time and manner in which simplified reports shall be filed by the employer or plan administrator of a plan receiving contributions deductible under this section."

SEC. 5. TREATMENT OF DISTRIBUTIONS FROM PLAN TO WHICH EMPLOYEE MADE DEDUCTIBLE CONTRIBUTIONS.

(a) Subpart A of part I of subchapter D of chapter 1 of such code (relating to retirement plans) is amended by inserting after subsection (1) of section 414, the following new subsection:

"(m) DEDUCTIBLE EMPLOYEE CONTRIBUTIONS.—For purposes of this title, other than for purposes of section 401(a)(4) and (5), 404, 410(b), 411, and 412, any amount which is allowed as a deduction under section 220 as a qualified retirement savings contribution shall be treated as an employer contribution."

(b) Section 414(h) of such Code (relating to tax treatment of certain contributions) is amended by inserting after "any amount contributed" the following: "(other than an amount described in subsection (m))".

SEC. 6. TECHNICAL AND CONFORMING AMENDMENTS.

(a) ESTATE AND GIFT TAX EXCLUSION.—

(1) ESTATE TAX.—Subsection (c) of section 2039 of such code (relating to exemption of annuities under certain trusts and plans) is amended by adding at the end thereof the following new sentence: "For purposes of this subsection, any contribution allowed as a deduction under sections 219 or 220 shall be considered as made by a person other than the decedent."

(2) GIFT TAX.—Subsection (b) of section 2517 of such code (relating to transfers attributable to employee contributions) is amended by adding at the end thereof the following new sentence: "For purposes of this subsection, any contribution allowed as a deduction under sections 219 or 220 shall be considered as made by a person other than the employee."

(b) OTHER AMENDMENTS.—

(1) Paragraph (10) of section 62 of such Code (defining adjusted gross income) is amended by striking out "(relating to retirement savings for certain married individuals)" and inserting in lieu thereof "(relating to deduction for certain employee retirement savings contributions)".

(2) So much of section 72(f) of such code as precedes paragraph (1) thereof is amended to read as follows: "In computing, for purposes of subsection (c)(1)(A), the aggregate amount of premiums or other consideration paid for the contract, for purposes of subsection (d)(1), the consideration for the contract contributed by the employee, and for purposes of subsection (e)(1)(B), the aggregate premiums or other considerations paid, amounts which an employer is required to report, pursuant to regulations promulgated under section 220(d) with respect to an amount paid by an eligible employee (as defined in section 220(c)(2)) as a qualified retirement savings contribution shall be excluded, and amounts contributed by the employer shall be included, but only to the extent that—"

(3) Section 415(a) of such Code is amended by repealing paragraph (3) thereof.

(4) The table of sections for part VII of subchapter B of chapter 1 is amended by striking out the item relating to section 220 and inserting in lieu thereof the following:

"Sec. 220. Deductions for certain employee retirement savings contributions."

SEC. 7. EFFECTIVE DATES.

(a) GENERAL RULE.—Except as provided in subsection (b), the amendments made by this Act shall apply to taxable years beginning after December 31, 1980.

(b) ESTATE AND GIFT TAX PROVISIONS.—

(1) ESTATE TAX.—The amendments made by section 4(a)(1) shall apply to the estates of decedents dying after December 31, 1980.

(2) GIFT TAX.—The amendment made by section 4(a)(2) shall apply to transfers after December 31, 1980.



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"Congressman Henson Moore: Republicans Advance Thrift Incentive for Reagan Tax Plan." [Press release], February 12, 1981.



3. S. 243—Senators Chafee, Warner, and Thurmond  
Savings and Retirement Income Incentive Act of 1981

a. Permanent interest and divided exclusion (sec. 2 of the bill)

*Present law*

Individuals may exclude from gross income up to \$200 (\$400 on a joint return) of dividends and interest income received from domestic sources (Code sec. 116). This provision is effective for taxable years beginning after December 31, 1980, and before January 1, 1983. After 1982, the exclusion reverts to prior law, under which the exclusion applied only to dividends and was limited to \$100 (\$200 in the case of a joint return). This is reflected in the revenue estimates (below) for 1983 and later.

*Issues*

This section of the bill specifically raises the issue (1) whether the partial exclusion for dividends and interest should be made permanent, and (2) whether the amount of the exclusion should be increased for individuals who are age 65 and older.

*Explanation of provision*

Section 2 of S. 243 would make permanent the partial exclusion of dividends and interest by individuals.

In addition, the provision would increase the aggregate amount excludible to \$500 (\$1,000 in the case of a joint return) for an individual who attains age 65 before the close of the taxable year or who is married, at the close of the taxable year, to an individual who is at least 65 years old.

*Effective date*

The provisions of section 2 of S. 243 would be effective for taxable years beginning after December 31, 1980.

*Revenue effect*

Fiscal year budget receipts would be reduced by \$105 million in 1981, \$771 million in 1982, \$1,742 million in 1983, \$4,278 million in 1984, and \$4,391 million in 1985.

b. Individual retirement and savings accounts (secs. 3-6 of the bill)

*Present law*

An individual generally is entitled to deduct the amount contributed to an individual retirement account or annuity, or used to purchase retirement bonds (referred to collectively as "IRAs"). The limitation on the deduction for a taxable year is generally the lesser of 15% of compensation for the year or \$1,500. Under a spousal IRA, the \$1,500 contribution limit is increased to \$1,750 for a year if (1) the contribution is divided equally between an individual and the spouse



of the individual, and (2) the spouse has no compensation for the year. However, no IRA deduction is allowed for a taxable year to an individual who is an active participant during any part of the taxable year in a qualified pension, profit-sharing, or stock bonus plan, a tax-sheltered annuity maintained by a tax-exempt organization or educational institution, or a governmental plan (whether or not qualified). Except for tax-free roll-overs and certain amounts paid for life insurance, nondeductible contributions are not permitted to be made to an IRA. Income and gain on amounts held under an IRA are not taxed until distributed. All distributions from IRAs are includible in gross income. Distributions may be made from an IRA without penalty after age 59½ or in the event of disability or death. Amounts held in an IRA can qualify for exclusions under the estate tax and gift tax rules.

Many qualified plans provide for contributions by both the employer and the employee. In many cases, the employee contributions are mandatory (i.e., required as a condition of employment, a condition of participation in the plan, or a condition of obtaining additional employer-derived benefits). In other cases, employee contributions are voluntary, and the amount, within limits, is left to the discretion of the employee. A plan can provide for both mandatory and voluntary employee contributions. In any case, neither employer nor employee contributions to a qualified retirement plan may discriminate in favor of employees who are officers, shareholders, or highly compensated. Generally, in the case of voluntary employee contributions, within certain limits, there is presumed to be no discrimination so long as there is an equal opportunity for all employees to make such contributions. Income allocable to an employee's contributions to a qualified plan is generally not taxed to the plan or to the employee before the income is distributed or made available to the employee or the employee's beneficiary. However, the employee is not entitled to a deduction or exclusion for employee contributions to the plan. Benefits held in a qualified plan can qualify for exclusions under the estate tax and gift tax rules to the extent the benefits are not attributable to employee contributions.

In the case of tax-sheltered annuities (including custodial accounts investing in shares of a regulated investment company) purchased by certain tax-exempt institutions for their employees or purchased by schools for teachers, employees are entitled to an exclusion, within limits, from gross income for amounts paid by the employer on a salary reduction basis. Amounts invested in a tax sheltered annuity purchased by a tax-exempt organization can qualify for exclusions under the estate tax and gift tax rules.

#### *Issue*

The issues are whether the present tax incentives for individual retirement savings accounts should be expanded and whether distribution from the accounts also should be allowed for educational purposes and for the purchase of the first principal residence.



### *Explanation of the bill*

#### *Deductible contributions*

The bill would increase the annual limit on deductible retirement savings contributions to 100 percent of the first \$2,000 of compensation includible in gross income. In addition, the bill would extend eligibility for deductible retirement savings contributions to individuals who are active participants in qualified plans, tax-sheltered annuity programs, or governmental plans. The bill would delete the special \$1,750 deduction limitation for spousal IRAs.

Under the bill, deductible retirement savings contributions could be made by an individual to (1) a qualified plan in which the individual is an active participant or (2) to an IRA. No deduction would be allowed, however, for mandatory employee contributions to a plan. Contributions to a qualified plan or to an IRA made before the time for filing the tax return for a year could be taken into account as if made on the last day of the year for which the return is filed.

Under the bill, benefits attributable to deductible employee contributions to a plan would be taxed under the same rules that apply to benefits attributable to employer contributions. Accordingly, these benefits would generally be taxed only when distributed or made available to the employee or a beneficiary, unless rolled over tax-free to another qualified plan or to an IRA. Such benefits could also qualify for exclusion under the estate and gift tax provisions.

Deductible employee contributions to a plan would be treated as employee contributions, however, in testing whether the plan meets the requirements for tax-qualified status and whether the plan meets the requirements of ERISA.

The bill provides for simplified reports with respect to deductible employee contributions received by plans.

#### *Nondeductible contributions*

The bill would allow nondeductible contributions to be made to an IRA. Although no deduction would be allowed for the contributions and they would not be excluded from estate or gift tax under the usual rules applicable to IRAs, the earnings attributable to nondeductible contributions would not be taxed until distributed. Nondeductible contributions would be subject to an annual limit of \$2,000. Nondeductible contributions of up to \$8,000 could be made over an individual's lifetime in addition to the amount contributed under the \$2,000 annual limit for nondeductible contributions. Under the bill, the limits for nondeductible contributions would be applied only after the limit on deductible contributions for a year is exceeded.

#### *Distributions for education and housing purposes*

Where nondeductible contributions have been made to an IRA, distributions from the IRA would be allocated under the usual annuity rules to determine the taxable portion, so that the part of each distribution consisting of nondeductible contributions would not be taxed. The bill would permit distributions to be made from an IRA without penalty to pay for certain educational expenses and would



permit distributions in connection with the purchase of the first dwelling purchased by the owner of the IRA if the dwelling is used as that individual's principal residence. Withdrawals for educational expenses or the purchase of a dwelling could not be less than \$2,000 and could not reduce the amount held in the IRA below \$2,000. Also, total withdrawals for these purposes could not accumulate to more than \$10,000.

Under the bill, withdrawals for educational expenses could be made to pay for (1) tuition and fees at an educational institution, (2) fees, books, supplies, and equipment for courses of instruction, and (3) a reasonable allowance for meals and lodging. An institution would qualify as an educational institution if it is an institution of higher education<sup>2</sup> or a vocational school.<sup>3</sup>

#### *Effective dates*

Generally, the amendments made by the bill would apply to taxable years beginning after 1980. The estate and gift tax amendments would apply to estates of decedents who die after 1980 and to transfers made after 1980 (respectively).

#### *Revenue effect*

It is estimated that this bill will decrease budget receipts by \$118 million in fiscal year 1981, \$2,754 million in 1982, \$2,992 million in 1983, \$3,620 million in 1984 and \$3,907 million in 1985.

<sup>2</sup> As defined in section 1201(a) or 491(b) of the Higher Education Act of 1965.

<sup>3</sup> As defined in section 195(2) of the Vocational Education Act of 1963 in any State (as defined in section 195(8) of that Act).



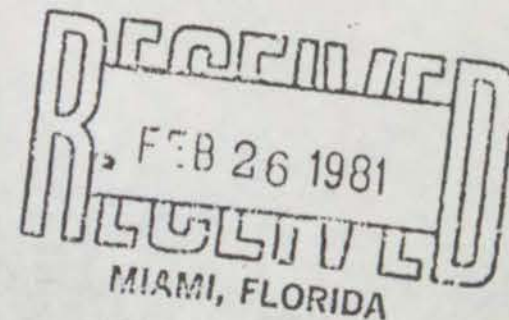
HARRY Z. ROSENBERG

Office (305) 771-220  
Res. [REDACTED]

February 20, 1981

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Senator Paula Hawkins  
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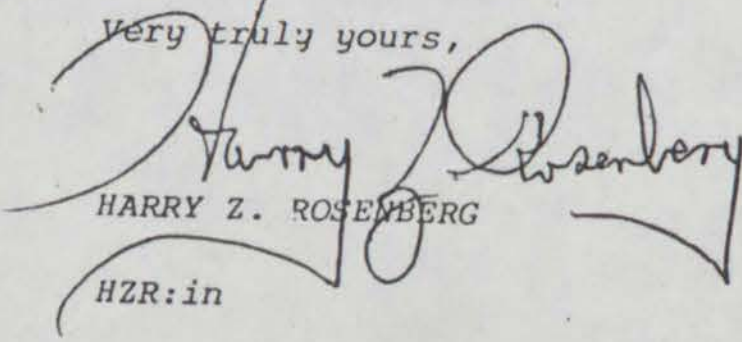
Dear Senator:

I would like to call to your attention a growing practice by both major and smaller domestic banks and most international and foreign banks that I can assure you is infuriating businessmen both of my small calibre up to the largest. These firms and businessmen can sight far more examples and probably more of a flagrant nature than I and business associates of my acquaintance have experienced. I am referring to the common and ever increasing practice of these banks taking advantage of the present high interest rates in delaying the normal banking transactions such as wire transfers and funding of letters of credit and numerous other transactions whereby they have been able to make use of the clients or depositors funds, from a minimum of one extra day up to as much as a week or more longer than these transactions normally use to take.

The depositor, victim, is given all sorts of excuses such as a break down of the telex machines and computers, to a delay in the mail, to a misplacing of documents. Each incident is a different excuse and almost any person I have spoken to engaged in financial transactions has had experiences of this nature. Most of these people just express a feeling of utter frustration because they do not know to whom these practices could be reported, who could regulate them and who could stop them from occurring.

I believe this is a matter that eventually involves huge sums of money improperly manipulated by these most honorable "institutions". I would like to request that you refer this matter to the proper committee or parties who could make a thorough investigation. I feel quite certain such an investigation would develop findings far beyond what I have suggested.

Very truly yours,

  
HARRY Z. ROSENBERG

HZR:in





BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON, D. C. 20551

April 14, 1981

PAUL A. VOLCKER  
CHAIRMAN

The Honorable Arlen Specter  
United States Senate  
Washington, D. C. 20510

Dear Senator Specter:

Thank you for your letter asking me to comment on the relationship between federal spending and interest rates and soliciting my advice on measures Congress might take to lessen the impact of high interest rates.

We agree that high interest rates are fundamentally caused by rapid inflation. Disciplined monetary and fiscal policies are essential to curbing inflation, and thereby effecting a lasting reduction in interest rate levels. Cutting federal spending is a key part of this process because it reduces demands on productive capacity and credit markets, and helps to convince the public that high rates of inflation will not be tolerated. By lessening federal borrowing requirements, reductions in expenditures accompanied by lower federal budget deficits will offer some immediate relief to financial markets, but a substantial decline in interest rates, and their maintenance at a lower level, will require a permanent reduction of inflation accompanied by an easing of inflationary expectations. This process will not be easy, and I cannot reliably predict when we will experience appreciable results. Inflation has become deeply entrenched in our economy over the last 15 years, and we may have to endure a period of slow economic growth and relatively high interest rates before we can restore confidence that inflation is being brought under control.

The speed with which the economy and financial markets respond to anti-inflationary policies will depend both on the vigor with which we pursue these policies and the public's perception of our willingness to stay on course. In this context, I believe a thorough review by the Congress and the Administration of various federal measures that tend to raise costs and prices could be very helpful. Action to pare unwarranted regulations,



The Honorable Arlen Specter  
Page Two

for example, would not only reduce costs for businesses and consumers, but would build public confidence in the direction of policy and speed the response of markets to our efforts.

I hope you find these comments helpful.

Sincerely,

*S/Paul A. Volchok*

DLK:JLK:vcd (V-90)

bcc: Mr. Kichline  
Mr. Kohn  
Mrs. Mallardi (2) ✓



April 14, 1981

The Honorable J. William Stanton  
House of Representatives  
Washington, D. C. 20515

Dear Mr. Stanton:

I am pleased to furnish you with a copy of  
my responses to the written questions you submitted  
in connection with the hearing held on February 26.

Please let me know if I can be of further  
assistance.

Sincerely,

S/ Paul

Enclosure

CO:vcd

bcc: Mrs. Mallardi (2) ✓  
Gov. Gramley  
Messrs. Prell, R. Smith, Kaiman, Allison



Chairman Volcker subsequently submitted the following responses to written questions from Congressman Stanton in connection with the hearing before the House Banking Committee on February 26, 1981.

Mr. Stanton

1. M-1B

- (a) In Table 1 of your testimony, you present two M-1B target ranges for 1981. One is 3-1/2 to 6 percent for 1981 growth after adjusting for ATS and NOW accounts. The other is 6 to 8-1/2 percent before the adjustment. My question is this: For M-1, measured inclusive of ATS and NOW accounts, which is the M-1B you report and we see, and which averaged \$413 billion in the fourth quarter of 1980, are you targeting it to grow by 3-1/2 to 6 or by 6 to 8-1/2 percent this year?

Our basic target is for growth in M-1B of 3-1/2 to 6 percent over the year ending in the fourth quarter of 1981, abstracting from the effects on M-1B of shifting into NOW accounts. Based on our staff's projections of the impact of such shifting, we are estimating that achievement of that targeted growth will result in an observed increase in M-1B of between 6 and 8-1/2 percent from the \$413 billion fourth quarter level of 1980. The estimate of the impact of NOW account shifts will be reviewed from time to time.

- (b) In the White Book that accompanied President Reagan's February 18th message to Congress, it is said that: "the economic scenario assumes that the growth rates of money and credit are steadily reduced from the 1980 levels to one-half those levels by 1986." Assuming that "steadily" means beginning now and continuing until 1986, is it possible that if M-1B grew as much as 8-1/2 percent this year it would be at variance with Administration expectations, or do you think they know that you have in mind some new M--M-1B after adjustment for ATS and NOW accounts?

I believe that the 3-1/2 to 6 percent range is the economically meaningful measure of the targeted growth of M-1B and that our target is thus entirely consistent with the Administration's assumption.



- (c) Implicit in your decision to target observed M-1B growth at 6 to 8-1/2 percent this year, is the assumption that the rate of rise of its velocity will fall 2-1/2 percentage points this year because of the spread of ATS and NOW accounts. However, if this is a wrong assumption, if ATS and NOW accounts once opened behave like other transactions deposits no matter where they came from, then won't you be preserving rather than fighting inflation?

While we have no "official" economic forecast, and thus no unique velocity forecast, the sense of your assumption that measured M-1B velocity would be expected to slow relative to trend as a result of transfers from savings accounts is correct. I believe it unlikely ATS/NOW accounts will behave just like demand deposits because of the savings component. We will be monitoring closely the behavior of the monetary aggregates throughout the year. If it becomes evident that the growth ranges as we have developed them are inconsistent with the fundamental objectives of policy--fighting inflation being preeminent--then we will adjust them.

- (d) Will you publish at least monthly M-1B after you adjust it so that we can monitor its behavior, and tell us how you adjust it?

As I indicated in my testimony, we intend to keep the Congress--and the general public--apprised of our estimates of the adjusted growth of M-1B. We have already begun to do so, presenting data that permit others to construct alternative estimates if they wish to do so.

- (e) Will you avail yourselves of the opportunity to revise your thinking and target in July, if the facts then warrant?

We certainly will be reassessing our targets--on both adjusted and unadjusted bases; and for all the aggregates--prior to the July report to the Congress under the Humphrey-Hawkins Act.



Mr. Stanton

2. Suppose there are large tax cuts relative to expenditure cuts, while at the same time the Fed cuts money growth 2, 3, and 4 percentage points. What will happen to interest rates?

In the short run, interest rates presumably would be higher than otherwise, all other exogenous factors being equal. The larger federal deficit would add to Treasury demands on the credit market; it would also tend to expand the aggregate demand for goods and services, and the resultant stronger desire for transactions balances would press against a smaller money stock.



Mr. Stanton

3. How can real interest rates increase very much in the United States from cutting tax rates in view of the demonstrated international mobility of capital?

It is true that with capital free to move internationally there is a long-run tendency toward equalizing of real rates of interest among countries.

However, it seems to be the case that divergences among real interest rates can persist for some time, as purchasers and suppliers of goods and services adjust to changes in prices among countries. Moreover, market imperfections, including various controls on capital flows, may prevent a complete equalization of international interest rates. Because the U.S. economy is such a large part of the world economy, however, a rise in real interest rates here, though moderated by the tendency of capital to flow in from abroad, would tend to raise the level of real interest rates in the world economy.



Mr. Stanton

4. There is considerable dispute about the effects of a tax cut on real activity and inflation. Demand management oriented economists tell us cuts in tax rates will operate to increase real activity (at least when, as now, there is plenty of slack in the economy--more than in 1963) and also to increase inflation. Supply siders tell us cutting tax rates will increase real activity and decrease inflation. Thus, there is agreement that real activity will be increased by cutting taxes--but disagreement about the inflationary impact. What do you think? Could it be a stand-off?

Tax cuts, considered in isolation, result in people having more disposable income; some of this is saved, some spent.

As a result there is likely to be a tendency to increase consumption. Other things equal (including the money supply) there will also be a tendency to increase interest rates, restraining private investment and spending, as a result of the larger deficit, at least in the short run. The additional consumption can add to inflationary pressures, with the degree of impetus to prices depending in part on prevailing levels of resource utilization in the economy, but if money is held unchanged that effect would be dissipated over time. The question is whether investment would be dampened in the process with long-term adverse effects.

Tax reduction will also have incentive effects tending to add to supply. Whether the net effect will be to improve investment and ease pressures on prices is at issue, and would depend partly on the design of the tax reduction. What does not seem to me at issue is that the effects will be favorable if tax reduction is accompanied by spending cuts--the point I have emphasized.



Mr. Stanton

5. In your statement, you caution observers of monetary policy to avoid placing undue reliance on weekly monetary aggregate figures and you emphasize that short-term swings in the monetary aggregates should not be disturbing provided there is an understanding of the Federal Reserve's monetary control over time. In this regard, should the Federal Reserve consider shifting from weekly to monthly money supply reporting? If the Board and the FOMC feel that weekly monetary statistics tend to be unreliable, would it be reasonable to delay publication of the M-1 statistics until they are final?

In a recent letter to Senators Garn and Proxmire I indicated that the Board is considering several alternatives to its current publication procedures for the monetary aggregate data. These include abandonment of weekly publication or some delay. We have invited public comment on these proposals.



Mr. Stanton

6. The advent of automated teller machines has created a great demand for high quality currency. Given the various services the Fed already performs for depository institutions, has the Fed considered contracting with depository institutions to provide high quality currency to such institutions at an appropriate cost plus profit? It is my understanding that the Fed does not currently provide such a service.

The question of charging depository institutions for high quality currency has undergone intensive review. A proposal addressing this issue is under consideration by the Board of Governors.

The proposal, brought to the Board by a special study group set up to make recommendations on this and other cash questions, is that depository institutions should not be charged for receiving automated teller machine (ATM) quality currency.

There are several reasons urged by the study group for continuing to provide this service to the depository institutions free of charge.

One, there is a general policy that currency processing activities are deemed to be governmental responsibilities and that governmental responsibilities are not priced. The sorting of currency according to quality would be classified as such a processing activity.

Two, Reserve Banks are now in the process of installing state-of-the-art high speed processing equipment that can provide the type and quantity of high quality currency needed for use in ATM's. These high speed machines are already producing high quality notes at a number of Federal Reserve offices.

The ATM quality currency produced by this equipment is regularly distributed to depository institutions as it becomes available. Further, by 1984, each Federal Reserve office which



processes more than 100 million notes annually will run all their machineable currency on this new equipment. This currency, in combination with the distribution of new notes, should ensure that depository institutions receive sufficient quantities of ATM quality currency. Charging for currency processed on high speed equipment in the interim period would not increase the supply of ATM money, but might unfairly alter patterns of distribution that are currently set up on the basis of efficiency and need.

Finally, furnishing only new currency for the rapidly growing ATM market is not recommended as a long term policy because the amount of new currency required for such purposes will soon exceed the amount needed to replace note redemptions in any given year. Since the currency system will only accommodate that quantity of currency which the public demands at any time, the issuance of excess quantities of new currency would eventually strain on Federal Reserve facilities to store ever increasing quantities of reusable fit currency. I do not know whether the Board will deem these arguments persuasive, as against the alternative you suggest.



April 14, 1981

The Honorable George Hansen  
House of Representatives  
Washington, D. C. 20515

Dear Mr. Hansen:

I am pleased to furnish you with a copy of  
my responses to the written questions you submitted  
in connection with the hearing held on February 26.

Please let me know if I can be of further  
assistance.

Sincerely,

S/Paul A. Volcker

Enclosure

CO:vcd

bcc: Mrs. Mallardi (2) ✓  
Messrs. Prell, Lindsey



Chairman Volcker subsequently submitted the following responses to written questions from Congressman Hansen in connection with the hearings before the House Banking Committee on February 26, 1981.

Mr. Hansen

1. What is the real meaning of a "prime" lending rate at a bank? Is it not misleading to publicize such a rate as the "best" rate, when in fact loans are offered at discounts to everyone? Should the federal government do something to put some definition on the term and make it more uniform and thus more meaningful and useful to the consumer--particularly that small businessman or farmer who only borrows occasionally and who does not engage in overnight loan practices?

The meaning of the term "prime rate" has indeed become obscured by changes in bank lending practices. However, the below prime lending that has occurred has generally involved special categories of credits--usually very large, very short-term loans, which differ in character from the bulk of loans that are tied to the prime rate. Thus, the misunderstanding and possible inequities involved are not so great as might appear the case at first blush. I don't think that it would be useful for the federal government to get directly involved in the matter of trying to define the "prime rate." Bank lending rates to particular customers necessarily and properly involve a variety of credit and customer considerations, and attempts to arrive at and enforce an official definition would, all too likely, tend to create artificialities and distortions of lending practices. Our primary reliance must be on maintaining a highly competitive financial system, with a variety of choices by borrowers. I would also hope, in their own self-interest in maintaining well understood relationships with their clients, banks will consider means of clarifying their use of the "prime rate" terminology.



Mr. Hansen

2. Some question has arisen about whether the various Federal Reserve Banks are really getting detailed and useful information reflecting actual market and credit conditions from different parts of the country. If so, are they responsibly including it in their evaluation process so there is full awareness of such conditions? Are they then, in a systematic way, passing this information on to the Federal Open Market Committee and the Board of Governors? Do you regard this flow of information as an important current justification for the regionalized structure of the Federal Reserve System, which seems to be unique among central banks? If this function is not being fulfilled--and I have evidence that this is sometimes the case--should Congress examine the regional structure with a view to altering it so as to assure that this function is consistently served?

I believe that the Federal Reserve Banks are providing intelligence about economic developments in their regions in a way that is useful for monetary policy. The economic research and other departments of the Banks provide their Presidents with information on economic and financial developments in their districts. They also communicate information to the Board staff and Board members through various channels, including regular formal reports before each Open Market Committee meeting.

I might add the Federal Reserve is not quite unique in a regional structure--the German central bank, for instance, was in certain respects modeled on the Federal Reserve. I would be interested in any specific suggestions you might have about uses of appropriate regional information, or how our intelligence network might be improved in that respect.



Mr. Hansen

3. In your statement and in your report, you refer several times, as you did under oral questioning, to the superiority of present operating procedures in open market operations, especially saying that these procedures are fully adequate for periods of a month or longer. If that is so, why was the growth of money so explosive for six months together in 1980, particularly in view of the statement in your July report that it would not be the aim of the Federal Reserve to move back onto the target path in one extraordinary movement, after the stall-dive behavior of the aggregates early in 1980?

The volatility of the money stock last year--not from month to month but over several months--was largely a reflection of the extraordinary nature of the economic circumstances. Focusing on the developments of the summer and fall, to which you refer, the money stock did indeed grow at a very fast rate over a period of several months. The economy during that time was growing rapidly--much more rapidly than almost anyone had expected or realized at the time--and this was boosting the public's demands for transactions balances. In retrospect, it also appears that the public had abnormally reduced deposit holdings following the introduction of special consumer credit restraints in the spring, and sought to rebuild those balances later.

The Federal Open Market Committee's targets for monetary expansion were much lower than the growth that actually occurred and we did not provide non-borrowed reserves to support the rapid growth. The rapid money growth was clearly reflected in an increase in the need of banks to borrow the reserves required to support the increase in deposits and in a pronounced tightening of the money markets. This tightening



did tend to set in motion adjustments in the behavior of banks and the public that contributed to a deceleration of monetary growth late in 1980 and on into early 1981. The process of restraint indeed took longer to "take hold" than we anticipated, and because the deceleration occurred late in the period, the monetary aggregates did end up high relative to their ranges for 1980 when measured on the conventional fourth quarter average basis. However, taking a broader view and recognizing events around year end, the "misses" were minimal or nonexistent. I believe (and there is a great deal of evidence to support the belief) that it is the general trend of monetary growth over substantial periods that is significant in terms of achieving the fundamental objectives of policy.



Mr. Hansen

4. In addition to moving to contemporaneous reserve accounting, would it be helpful for the Federal Reserve to stagger reserve settlement days over each week?

The advantages and disadvantages of staggering reserve accounting periods have been studied over the years. These studies have suggested that the advantages of reduced reserve management pressures on depository institutions late in the reserve settlement week and the associated smoother day-to-day movements in the federal funds rate under a system of staggered accounting would come at the expense of a looser relationship between the monetary and reserve aggregates and an accompanying deterioration in monetary control.

The source of both outcomes is the characteristic of a staggered system that allows institutions to transfer reserve surpluses or deficiencies among themselves through federal funds transactions across settlement weeks. This characteristic provides an automatic mechanism for smoothing the impact on the federal funds rate of self-correcting, short-run fluctuations in non-controlled factors affecting reserves, such as float. However, the studies suggested it also can lead to the avoidance of systemwide balancing of reserve positions every week. In response to a permanent policy-induced change in reserves, institutions would be able to delay more basic balance sheet adjustments that would affect the monetary aggregates by transferring their reserve position imbalances to other institutions in the federal funds market. Systemwide imbalances could accumulate over time. Once institutions began undertaking



more basic balance sheet adjustments, such as asset purchases or sales, the elimination of the overall accumulated reserve imbalances could even require larger asset transactions and associated deposit changes than would be sustainable in the long run given aggregate reserves.

These complications in the reserves to money relationship would impair the Federal Reserve's ability to predict the consequence for movements in the money stock over time of a particular reserve target. A system of staggered accounting could well overturn the benefits for short-run monetary control potentially available under contemporaneous reserve accounting. The Federal Reserve is currently studying the operational feasibility of contemporaneous reserve accounting, as well as appropriate implementation schedules, and I intend to review again the evidence on staggered settlement days.



Mr. Hansen

5. Is there anything the Federal Reserve can do through monetary policy to predictably affect the division between growth and inflation in the space of, say, a year? If it can, is this in line with the Administration's thinking of what is needed for the next year? If it can't, why should the Federal Open Market Committee particularly worry from week to week about the emerging strength or weakness of the economy and try to react to it?

I don't believe that the Federal Open Market Committee any longer, if it once did, takes the kind of "fine tuning" approach of the sort you suggest. Our continuing effort must be to deal with inflation. We do, of course, feel it is important to keep abreast of short run developments in the economy and financial markets. There is some area of inevitable uncertainty attending the specification of monetary targets and their impacts on the economy, and we constantly assess incoming information that may shed light on those matters, and perhaps help us in adjusting our operations toward the specified targets, or, much more rarely, signal the need for adjustments in targets in order to maintain policy on the correct course with respect to the achievement of the ultimate objective of a stable, growing economy.

There is little the Federal Reserve can do directly, through the ordinary tools of monetary policy, to affect the inflation/growth "trade-off". However, expectations may indirectly affect the outcome, although without predictable precision. Those expectations would be influenced by monetary as well as other public policies in ways not easily distinguishable, but related, I believe, to perceptions of willingness to persist in policies of restraint.



Mr. Hansen

6. The recent behaviors of the consumer price index and the GNP deflator have been very different. Do you judge one index to be better than another for the general purpose of assessing the strength of inflationary pressures and the appropriateness of various possible policy responses?

There is no single price index that is an unambiguous, all-purpose indicator of inflation. The consumer price index has clear problems, particularly in the treatment of housing, that have been quite generally recognized. The GNP implicit deflator has other shortcomings, including a tendency toward some volatility as a result of the shifting weights that characterize its construction. The GNP consumption deflator may give a better reading.

In general, I do believe, in present circumstances of volatile and high interest rates, the consumer price index is often misleading, but a variety of indices, including the producer price index, is necessary to properly assess inflationary developments.



Mr. Hansen

7. The first chart on page 27 of your report shows that nonborrowed reserves were really quite stable from May to the end of 1980. The monetary base, adjusted for reserve requirement changes, increased from May to November by about 10 or 11% (on an annual basis), then turned nearly flat. M-1B likewise increased rapidly from May to November, then went flat. Apparently, stabilizing nonborrowed reserves through the period did not result in stable money growth. In view of the record, would not stabilizing of the monetary base have resulted in much more stable monetary growth?

Under present institutional arrangements, with banks able to borrow from the Federal Reserve, we cannot have assured control over the monetary base (or total reserves) in the short run, in any event, it is not possible to say precisely what pattern of monetary growth might have occurred had the System stabilized the growth of the monetary base over this period. There are considerable dangers in ex post comparisons of the sorts you make in your question, for the monetary base was in fact determined endogenously along with the money stock. The base is **most** heavily influenced by currency outstanding, rather than deposits which account for the bulk of the money supply. As a general matter, it should be noted that the staff's study of monetary control procedures suggested that nonborrowed reserves are a better operating target than the base under current institutional arrangements.

In the period to which you refer, the money stock was growing rapidly at first and the System did not accommodate that expansion through a corresponding provision of nonborrowed reserves. As banks were forced to turn to the discount window to satisfy their reserve requirements, this put upward pressure on market rates of interest and encouraged adjustments



by banks and the public that contributed to the weakening of monetary growth later in the year. At times, nonborrowed reserves were reduced in the light of the rapid growth in total reserves to speed up the adjustment process. The rise in borrowing was reflected in the growth of total reserves and the base.

If, instead, the System had been attempting to adhere to a path for total reserves or the base, the initial surge in the monetary aggregates would have required a reduction of non-borrowed reserves from what actually occurred. (Absolute adherence to a total reserve or base path in the short run in the face of a surge in money would, for all practical purposes, be impossible because it is necessary to meet the demands for currency and required reserves.) In such a circumstance, money market conditions would have tightened even more abruptly than they did. Such a development presumably would have prompted a quicker deceleration of monetary expansion, but the precise timing and dimensions cannot be estimated with any certainty. Furthermore, it is conceivable that there might have been subsequent oscillation in money, and interest rates as the System attempted to hold total reserves or the base on a steady course in the face of short-run disturbances to money demand and the reserves-money or base-money multipliers.



Mr. Hansen

8. Professors James M. Johannes and Robert H. Rasche of the Department of Economics at Michigan State University have presented extensive evidence (see the Econometrics Workshop Paper No. 7914) to show that, given their forecasting models the forecast errors at the various steps of the procedure are such that the monetary base is the dominant policy guide, compared to nonborrowed reserves. They say "We are unaware of any publicly available forecasting technique that dominates our results, or reverses the rankings of the two policy guides." Does the Federal Reserve's own forecasting technique overthrow these findings? If so, why were the results in actual practice so poor in 1980? If not, why does not the Federal Reserve adopt the superior policy guide? In any case, why does not the Federal Reserve publish its forecasting techniques?

The Federal Reserve staff study on the new monetary control procedures completed in February contained a paper entitled "Monetary Control Experience Under the New Operating Procedures" that addressed in detail the conclusions reached by Professors Johannes and Rasche. This paper first compared the accuracy of forecasts of the various multipliers (ratios of a monetary aggregate to a reserve measure) by the Johannes-Rasche model with the accuracy of multiplier forecasts made judgmentally by the Board staff in deriving reserve targets. Multiplier forecasts by Board and San Francisco Reserve Bank econometric models also were examined. From October 1979 to October 1980 the accuracy of the staff judgmental forecasts was superior on average to the accuracy of the Johannes-Rasche model forecasts, particularly for the nonborrowed and total reserve measures. The Board monthly model, whose equations have been made available to the public upon request, also yielded closer multiplier predictions than the Johannes-Rasche model.

The Board staff paper also examined how closely money could be controlled using alternative reserve measures as fixed operating targets over monthly periods. The Board and San Francisco models were simulated so as to abstract from the effects of movements in reserve measures that



are induced by movements in money and that potentially distort the multiplier results. Thus, these tests focused solely on the relationship going from reserves to money. The results indicated that the short-run connection between nonborrowed reserves and money was more reliable than the connection between the monetary base and money, under the current institutional and regulatory structure. Moreover, under a different regulatory structure embodying more predictable required reserve ratios, total reserves were more reliably connected to money than the monetary base.

The Federal Reserve came very close to attaining its announced ranges for growth of the narrow monetary aggregates over 1980 as a whole, despite sizable gyrations in monthly growth rates. The money stock is inherently noisy in the short run, and not amenable to precise week by week or month by month control.

However, the variability of money growth last year apparently was accentuated by an unusual combination of factors that destabilized the demand for money as the year progressed. These factors included sharp swings in economic activity and the imposition and subsequent removal of the credit control program. Had 1980 been a more "normal" year, money would have been much more likely to have remained within the bounds of the FOMC's longer-run range. This conclusion is documented in detail in another paper in the overall staff study, "Money Market Impacts of Alternative Operating Procedures."

The forecasting procedure used by the Federal Reserve in setting and adjusting its targets for reserve aggregates is predominantly based



on judgmental estimates of near-term relationships among financial variables. Unlike an approach utilizing only the Board's monthly model, this forecasting technique, by its very nature, cannot be reduced to a simple set of equations or formulas that might be published.



Mr. Hansen

9. The appendix to the Federal Reserve's report contains results of staff studies, ostensibly showing that no alternative policy procedures, specifically targeting the monetary base instead of nonborrowed reserves, could have resulted in smoother money growth and more stable credit markets in 1980. These results lean heavily on model simulations. These models gave us atrocious instabilities in 1980. Why should their results be trusted to evaluate hypothetical alternatives?

The staff research evaluating alternative reserve measures as potential operating targets relied in part on simulations of the Board and San Francisco Bank econometric models. But these simulations highlighted the impact on the money stock of the errors each month in the models' equations. In other words, the model simulations were designed to estimate the extent to which unexpected developments would disturb money from its predicted level when different reserve measures in turn are maintained at predetermined levels. Thus, the simulations did not ignore that fact that model equations are subject to error, but instead indicated the closeness of monetary control that is possible with different reserve targets in the face of these errors.

The results, which apply only to each model specifically, should be viewed as tentative, because no model perfectly represents the non-random, underlying structure of the economy. However, the fact that the results comparing nonborrowed reserves with the monetary base were similar for two models with quite different structures suggests some confidence in the general validity of the results.

In any event, while the two models did suffer rather large errors in several months in 1980, it would be a mistake to blame the observed



instabilities last year on the models, which were not relied on to any significant degree in conducting monetary policy. The model errors reflected last year's instabilities, but the cause of these instabilities was the economic factors discussed in the last question, not the models themselves.



April 14, 1981

The Honorable Ron Paul  
House of Representatives  
Washington, D. C. 20515

Dear Dr. Paul:

I am pleased to furnish you with a copy of  
my responses to the written questions you submitted  
in connection with the hearing held on February 26.

Please let me know if I can be of further  
assistance.

Sincerely,

*[Signature]*

Enclosure

CO:vcd

bcc: Mrs. Mallardi (2) ✓  
Messrs. Adams and Prell.



Chairman Volcker subsequently submitted the following response to a written question from Congressman Paul in connection with the hearing before the House Banking Committee on February 26, 1981.

Dr. Ron Paul

During a hearing conducted by the Economic Stabilization Subcommittee on February 25, Professor Amitai Etzioni suggested a device to reduce the annual interest payments on the national debt: the sale of gold-backed bonds. He pointed out that three weeks ago a private firm in Europe sold gold-backed bonds at 3.5% interest. I am enclosing a copy of his remarks in which he makes this suggestion. What is your reaction to this idea? Would you endorse it as a way to balance the budget, which you emphasized so much during your testimony?

While I can understand the concerns that prompted Professor Etzioni's suggestion, I have several reservations about his proposal. The essence of the proposal is that the Treasury sell indexed bonds -- in this case tied to the price of gold. I have generally been opposed to most forms of indexing as they reduce support for controlling inflation and in some cases actually help spread price increases. Professor Etzioni's proposal would place the U.S. Treasury in the position of speculating on the future price of gold, and in effect betting against those who buy the bonds -- I think this is inappropriate. The proposal's overall intent seems to be to reduce the cost of public borrowing now, and shift some of the burden into the future when the bonds would be paid off. However, if we are unwilling to pay the financing cost of the Federal deficit associated with current levels of government spending, a more appropriate response would be to cut the budget. If we wanted to finance current spending at the expense of reducing our assets, we could always sell gold directly. Americans now also have unrestricted opportunities to own gold in the form



of bullion, U.S.-produced medallions, foreign coins, claims on gold held in bank vaults, futures contracts, and in other forms. There is no reason to believe the ownership of a claim on the U.S. gold stock could provide, as Professor Etzioni suggests, benefits that are superior to those afforded by available investment opportunities.



April 14, 1981

The Honorable James K. Coyne  
House of Representatives  
Washington, D. C. 20515

Dear Mr. Coyne:

I am pleased to furnish you with a copy of my response to the written question you submitted in connection with the hearing held on February 26.

Please let me know if I can be of further assistance.

Sincerely,

C/Paul A. Volcker

Enclosure

CO:vcd

bcc: Mrs. Mallardi (2) ✓  
Mr. Prell



Chairman Volcker subsequently submitted the following response to a written question from Congressman Coyne in connection with the hearing before the House Banking Committee on Feb. 26, 1981

Mr. Coyne

What impact does our government's growing credit requirements have on national interest rates? How much, according to your econometric models, could interest rates be brought down if we could maintain a balanced federal budget for a period of 2-3 years or even longer?

All other things equal, a larger federal deficit implies higher market rates of interest. I don't think, however, our econometric model can offer any simple answer to your question regarding the impact of a balanced budget for several years. It would yield a variety of answers depending on the economic circumstances and other aspects of governmental policy--and any quantitative results would, as with all econometric models, be subject to a considerable degree of uncertainty. However, it is fair to say that reduced federal borrowing will result in less pressure on credit markets and in general, significantly lower interest rates.



April 14, 1981

The Honorable William D. Lowery  
House of Representatives  
Washington, D. C. 20515

Dear Mr. Lowery:

I am pleased to furnish you with a copy of  
my responses to the written questions you submitted  
in connection with the hearing held on February 26.

Please let me know if I can be of further  
assistance.

Sincerely,

*S/Edith A. Johnson*

Enclosure

CO:vcd

bcc: Mrs. Mallardi (2) ✓  
Messrs. Prell, Pizer, Kohn, Seiders, Keir



Chairman Volcker subsequently submitted the following responses to written questions from Congressman Lowery in connection with the hearing before the House Banking Committee on February 26, 1981

Mr. Lowery

Exports and Protectionism

Mr. Chairman, recently Dr. Fred Bergsten, Former Assistant Secretary of the Treasury for International Affairs, warned that continuing high interest rates will erode the competitiveness of U.S. exports, which have been growing at twice the rate of overall world trade for the past three years. He also warned that the U.S. faces massive protectionist pressures in the future. Would you comment on Dr. Bergsten's concerns and what role, if any, the Federal Reserve will play in these matters.

High nominal interest rates are symptomatic of high inflation rates, and consequently, they are likely to be associated with a deteriorating competitive position for U.S. exporters. The efforts of the Federal Reserve to reduce the rate of inflation will, over time, help to bolster U.S. competitiveness and create an environment conducive to a lower level of interest rates.

On the question of protectionist pressures, there is no doubt that they are rising both here and abroad. To a degree this is a reaction to low growth rates and high unemployment rates in most industrial countries. There are probably instances in which exports of some products from some countries are being encouraged by subsidies of one kind or another, and we would support a strong reaction in such cases. More generally, however, we believe that to turn back the tide of protectionism it will be necessary to pursue economic policies in the industrial countries that will support expansion without stimulating inflation. The policy of the Federal Reserve is to foster that kind of environment for the United States.



Mr. Lowery

Mr. Volcker, there has been some discussion of the possibility of establishing an IRA-type account for housing down payments. Should mortgage interest rates continue to stay at present levels, would you favor such an instrument for first-time homebuyers?

No, I would not. As a general matter, one must approach tax deferral and exclusion proposals very cautiously for they tend to involve the certain loss of tax dollars and enlargement of the federal deficit with uncertain benefits to the economy in terms of additional saving. The specialized plan you inquire about addresses a symptom of our current problem--high interest rates discouraging home purchases--rather than the problem itself, inflation. Moreover, it would put into place an additional subsidy program for housing that prove difficult to dismantle when the need had passed. The most effective way to eliminate the housing affordability problem is to curb inflation through consistent application of monetary and fiscal restraint.



Mr. Lowery

Mr. Volcker, there has been much discussion of the fact that mortgage interest rates are included in the CPI, and as is stated in the Report (page 41) the rise in mortgage interest rates in late 1980 included in the CPI "exaggerates the true change in the average cost of living." However, in my District in California, the 30-year, fixed rate mortgage is fast disappearing. Do you feel that with the current trend of VRM's and other less conventional mortgage instruments, interest rates on these types should in fact be included in the CPI, perhaps adjusted periodically?

It is widely recognized that the present treatment of home purchase costs in the Consumer Price Index has significant shortcomings. The index does not reflect in a satisfactory way the fact that homeownership involves both consumption and investment characteristics. There is less agreement, however, concerning the most appropriate treatment of financing and other homeownership costs in the CPI. The proliferation of adjustable-rate home mortgages adds another complicating technical factor in the construction of the index.

In a true cost-of-living index, the owner-occupied housing component would measure changes in the average cost of consuming the flow of shelter services provided by owner-occupied homes. This cost cannot be measured directly, however, since there are not corresponding market transactions for which prices can be collected. The Bureau of Labor Statistics currently is experimenting with a number of housing variants that represent attempts to measure the ideal concept indirectly. These alternatives have been under discussion at the BLS and elsewhere for some time and are being reviewed for the next CPI revision. The BLS is also considering how to deal with adjustable rate mortgages in the current CPI homeownership measure, but appropriate data are quite limited at present.



Mr. Lowery

The Competitive Environment Ahead

What is your response to these competitive pressures faced by all depository institutions? How should we in Congress begin to approach these issues? Isn't it time that we thoroughly review the Glass-Steagall Act with the view toward permitting depository institutions to compete for services similar to those which their competitors in the investment business now offer?

You are certainly correct in indicating that there have been significant changes in the institutional structure of financial markets and that there are strong pressures toward further change. It is important that we not permit outmoded regulations and statutes to impede an evolution of the markets in the directions dictated by fair and constructive competitive forces; we must, of course, at the same time make sure that the financial system remains sound and does not become a chink in our economic armor as we confront the many unpredictable shocks that can arise.

The Board is addressing some of the issues you raise. The question of equitable competition between money market mutual funds and depository institutions is one of these. A variety of Glass-Steagall issues, including revenue bond underwriting, have, as you know, come to the fore in recent years, and I think it is inevitable that many more will.



Mr. Lowery

Lower Inflation Rate

Given, the inflationary forces and the inflationary expectations which are embedded in our economy, is it reasonable to assume that the inflation rate can be cut to 8.3% as early as next year, as has been predicted, even assuming that President Reagan's entire program of tax and spending cuts is enacted? If not, what kind of inflation rate can we reasonably expect?

I see no fundamental reason that the rate of inflation cannot be cut to 8.3 percent next year. I think that such a result could be achieved with the least strain on our financial fabric if the federal deficit is kept to a minimum. But you are quite right in focusing on the inflationary expectations embedded in the economy. Whether we can achieve both a significant deceleration of inflation and strong economic growth is dependent in large measure on our success in turning the expectational momentum of inflation around--and I believe that a firm, credible commitment to monetary and fiscal restraint is essential to achieving an easing of inflationary expectations.



Mr. Lowery

Mr. Chairman, now that the Federal Reserve's discount window is available to all depository institutions, perhaps it is time to examine new ways to have the discount rate set in a manner that would improve monetary policy. Some observers, such as Milton Friedman, have suggested that the discount rate should be linked to a market rate such as the Treasury bill rate, so that it becomes a floating rate which changes continually rather than at uncertain intervals. Perhaps it should be viewed as a penalty rate in the future.

Has the Federal Reserve given any consideration to such a review of the discount rate? If so, what are you doing in this regard? If not, why not?

The staff of the Federal Reserve recently undertook an assessment of the procedure for setting the discount rate, as part of a more general review of its first year of experience with targeting open market policy on bank reserves. In this review consideration was given to the question whether monetary control would be improved by maintaining the discount rate consistently at a penalty above a pivotal short-term market rate, such as the federal funds rate, or by using a floating discount rate, tied in some fixed spread relationship to a key market rate. The staff's study revealed that the two techniques offer both advantages and disadvantages relative to the current approach; these are summarized below. The Board will continue to consider alternatives to present practices with respect to the administration and pricing of discount window credit.

#### Penalty Discount Rate

A penalty discount rate would tend to limit the discount window to a strict lender of last resort role. As a result, borrowers would be accommodated only when they had lost access to their usual market sources of funds (due to their own management errors), or when there was a more general squeeze on financial liquidity. The present role of



the discount window as a buffer in accommodating temporary bank needs for reserves would thus be largely eliminated, and any tendency for bank reserve demands to exceed or fall short of the supply being provided through Federal Reserve open-market operations would produce quicker and substantially sharper responses in market interest rates.

Where the overshoot or undershoot in demands for reserves resulted from a deviation of money growth from the FOMC's desired target rates, this more rapid response of market interest rates would be helpful, since it would tend to bring money growth back on target more quickly. Unfortunately, however, reserve needs often deviate from expected levels for reasons that have no relation to the underlying demand for money, and sharp interest rate responses to such changes would often be counterproductive.

For example, bank demands for excess reserves may deviate from forecast levels, or the deposit mix that determines required reserves may differ significantly from the projected pattern. With the discount window no longer serving as a buffer, any such stochastic discrepancy between the demand for and supply of reserves would be reflected in a much sharper response of interest rates than is now the case. There would be no guarantee that these rate responses would be consistent with what was needed to keep growth in the monetary aggregates within their desired ranges, and at times they could actually run counter to such needs, thereby exacerbating deviations of money growth from the desired targets.



Finally, it should be noted that under the present system of lagged bank reserve accounting, it would be technically impossible to keep the discount rate consistently at a penalty relative to the federal funds rate. Since required reserves in the current week depend on deposits two weeks before, in any situation where open market operations failed to cover all of the demand for required reserves (as might happen as a result of Federal Reserve misestimates of independent factors like float and currency in circulation that also affect bank reserves), the banking system would have to turn to the discount window to bring the total supply of reserves into equilibrium with demand. Individual banks with reserve shortages would seek first to meet their needs in the federal funds market. But because the supply of federal funds were insufficient to meet the total demand for reserves (due to the Fed's misestimate of the need for open market action), the federal funds rate would be bid quickly up to and above the discount rate. Only then would banks turn to the discount window to bring the supply of total reserves into balance with demand. This process of reaching an equilibrium could thus be expected to increase the volatility of market interest rates.

#### Tied Discount Rate

Advocates of a tied discount rate have generally suggested linking the discount rate in a fixed spread relationship to the federal funds rate, the 90-day Treasury bill rate, or some more general index of short-term market rates. Like the penalty rate



approach, the objective of a tied rate would be to insulate the volume of borrowed reserves against changes in market interest rates, so that adjustments to persisting deviations from targeted money growth rates would occur more quickly.

If the federal funds rate were selected as the tie, any attempt to link the discount rate to very recent levels of the federal funds rate could produce large, possibly explosive, movements in both the federal funds rate and other market rates. For example, if today's discount rate were tied to yesterday's federal funds rate, anything causing a change in yesterday's funds rate would lead to a further change in today's funds rate because of the tied increase in today's discount rate. This would induce still further changes in tomorrow's discount and funds rate, and so on.

This technical problem of induced interest rate volatility could be damped if the discount rate were tied to some lagged value of the federal funds rate instead of a very recent rate. The rationale for such a backward looking fed funds rate tie would be essentially two-fold. First, it would allow for some variation of the spread of the current fed funds rate over the discount rate and thus, by tolerating some increase in the volume of borrowed reserves, limit the risk of an interaction with the discount rate that ratchets the fed funds rate upward. This in turn would help to minimize the possible pitfall of linking the discount rate too tightly to a current rate series that is heavily influenced by strictly temporary shifts in demands for reserves



and not reflective of a basic trend in the demand for money. At the same time, a lagged tie of this type would help to keep spreads of market rates over the discount rate from reaching the unacceptably large proportions that have developed at critical points under the existing system of establishing the discount rate on a discretionary basis.

However, a tie of this type--with a sufficient lag to avoid too close a linkage to relatively current adjustments in money market conditions--would be quite unwieldy. For example, at times when the federal funds rate was declining, this approach would produce a penalty discount rate (with all its attendant problems) unless a special judgmental adjustment were made.

Use of a 90-day bill rate or a broader index of similar short-term rates as the tie, rather than the one-day federal funds rate, would help to minimize the destabilizing influence of very temporary changes in reserve demands. But it would also introduce certain technical complexities that could prove troublesome. For example, experience shows that in periods as short as the interval between FOMC meetings, most market rate series will frequently show temporary supply-demand distortions relative to the structure of other similar rates. Thus, any series used as an automatic tie would have to be reviewed regularly to determine whether temporary market factors were creating distortions that indicated a need to set the automaticity aside.



Where other central banks have introduced tied rate procedures for setting their discount rates, they have always had to wrestle with the question whether the objective of tying should take precedence over other policy considerations. Generally, to accommodate other overriding policy needs, the rules for those other ties have had to be breached frequently. After a period of mixed results, the experiments have typically been abandoned.



April 14, 1981

The Honorable Norman D. Shumway  
House of Representatives  
Washington, D. C. 20515

Dear Mr. Shumway:

I am pleased to furnish you with a copy of  
my responses to the written questions you submitted  
in connection with the hearing held on February 26.

Please let me know if I can be of further  
assistance.

Sincerely,

S/Paul A. Volcker

Enclosure

CO:vcd

bcc: Mrs. Mallardi (2) ✓  
Messrs. Prell, Simpson, Lindsey, Humphrey, Ring



Chairman Volcker subsequently submitted the following responses to written questions from Congressman Shumway in connection with the hearings before the House Banking Committee on February 26, 1981.

Mr. Shumway

1. To what extent have the revenues accruing to the Treasury as a result of the Federal Reserve requirement increased in the past two years? What is the projection for FY 1982? In future years?

The primary source of Federal Reserve revenues is earnings on our portfolio of government securities. Most of these revenues are returned to the Treasury each year, after a deduction for Federal Reserve operating expenses. Revenues accruing to the Treasury solely as a result of Federal Reserve reserve requirements represent about one quarter of the System's earnings on its securities holdings. Revenues derived from reserve requirements were \$2,080 million in 1978; \$2,640 million in 1979; and \$2,995 million in 1980. The increase in revenues over the past two years (1978-80) from reserve requirements alone is thus \$915 million, or 44 percent. The main source of this rise was the 33 percent increase in the average return on the System's portfolio from 1978 to 1980. Average reserve balances at the Federal Reserve Banks grew 8.5 percent during this period. The projection for revenues from reserve requirements alone in fiscal year 1981 is \$2.5 billion. For future years the projections are: \$2.3 billion in fiscal year 1982, \$2.0 billion in fiscal year 1983, and \$1.8 billion in fiscal year 1984. Reserve requirement revenues fall because of the



reduction in reserve requirements mandated by the Monetary Control Act. However, as you know under the Monetary Control Act we have begun charging for the services provided by the Federal Reserve Banks. Total revenues from reserve requirements and service charges will be higher than if the Monetary Control Act had not been passed. Obviously, these projections of revenues are sensitive to assumptions about the extent and composition of deposit growth and about interest rate movements; consequently, they must be viewed as quite uncertain. Total Federal Reserve earnings will also be affected by other factors such as the growth of currency.



Mr. Shumway

2. What accounts for this rapid rise in revenues, which have apparently more than doubled in only five years?

By 1980, Treasury revenues specifically due to reserve requirements, \$2,995 million, had grown by 71 percent from their 1976 level. However, total Federal reserve payments to the Treasury in 1980, \$11.7 billion, were \$5.8 billion more than in 1976. Most of this rise was due to an increase in the average rate of interest earned on U.S. government securities, which rose from 6.70 percent in 1976 to 9.73 percent in 1980, reflecting the upward trend in rates. The remainder was due to earnings derived from additional holdings of securities, which averaged \$128.2 billion in 1980 compared with \$96.8 billion in 1976. This substantial increase in security holdings largely reflected the continuing growth of currency in circulation, which in 1980 averaged \$38.9 billion more than in 1976. A smaller portion reflected the increase in reserve balances described in question 1.



Mr. Shumway

3. During the protracted debate leading to passage of the Monetary Control Act, the Treasury Department insisted that a minimum acceptable revenue floor existed, and that the reserve requirement had to be sufficient to limit revenue losses. In fact, it is my recollection that the reserve requirements eventually established were based more on this concern with revenues, rather than with the questions of monetary control. Do you think this is an accurate assessment of the situation?

The Treasury was indeed concerned with the potential revenue effects of the Monetary Control Act. To address that concern, the Federal Reserve provided revenue estimates to the Treasury. These were later published in the Congressional Record-Senate (March 27, 1980, pp. S3172-4). These estimates showed that, compared to an environment without the MCA, passage of the MCA should on balance lead to a modest increase in Treasury revenues. The concerns of the Federal Reserve, naturally, were with the monetary control implications of the MCA. Monetary control is enhanced when more financial institutions are subject to reserve requirements in excess of vault cash holdings. The legislation subsequently adopted by Congress represented a balancing of the need for improved monetary control, the revenue concerns of the Treasury, and other economic considerations. Thus no single concern dominated the final form of the MCA.



Mr. Shumway

4. As a result of the mandatory reserve provisions of the Monetary Control Act, certain competitive burdens are being disproportionately borne by many small and medium banks -- particularly as the deregulation process accelerates. As you are aware, non-member banks were given an eight-year phase-in period in which to reach their required level of reserves, while similar banks, who had been members of the Fed, were forced to meet their full reserve requirements immediately. I have been contacted by several banks who feel this is quite unfair. One way in which the problem of disproportionate reserve burdens might be somewhat mitigated would be to reduce the reserve requirement. In view of recent revenue increases, what are your thoughts?

The reserve requirement provisions contained in the Monetary Control Act reflect detailed and lengthy negotiations among a variety of interested groups. While all similar financial institutions will ultimately have the same reserve requirements, this will not happen until after a prolonged phase-in period. Thus, you are correct that member banks will be required to maintain higher reserves than otherwise similar institutions during the phase in. However, member banks' reserve requirements will be less than would have been the case without the Monetary Control Act. If there was sufficient Congressional interest, it would be possible to amend the Monetary Control Act to have more uniform reserve requirements sooner. The benefit of doing this would, of course, have to be weighed against the cost in terms of foregone revenues to the Treasury as well as any impact on monetary policy.

With respect to institutions that left the Federal Reserve System shortly before the Monetary Control Act was passed, the legislation is quite specific. It specifies that those



nonmembers that left the System between July 1, 1979 and March 1, 1980 are to be regarded as member banks for reserve requirement purposes. The legislative history of the Act indicates that the purpose of this provision was to ensure that member banks that left the System while the MCA was being considered actively by the Congress would not obtain a windfall reserve requirement reduction as a result of the nonmember bank phase-in provision; indeed, it was felt that such former members were better able to restructure their assets to comply with higher reserve requirements than other nonmembers. Although it might be argued that some relief could be granted to these former member institutions by lowering their reserve requirements, the Act requires the Board to establish uniform reserve requirements for all types of depository institutions, thereby precluding selective changes for some types of institutions.



Mr. Shumway

5. Would you briefly describe the process by which monetary targets are set? What specific economic criteria are relied upon? How consistently have monetary targets been reached in recent years?

This set of questions is very broad and might require dozens of pages to treat fully. I shall follow your indication that I may be brief. The Federal Reserve's Report to The Congress on Monetary Policy discusses these issues in much more detail.

The Federal Open Market Committee sets the targets for monetary growth in light of a broad range of analysis and information brought to it by the staff of the Board and the Reserve Banks on all aspects of the economy and financial markets. The FOMC members also, of course, have insights drawn from their own extensive contacts in the private and public sector. It is impossible to pinpoint a set of "specific economic criteria" that are determining in the decision-making process. The broad goals of policy have been laid out repeatedly, including in the Humphrey-Hawkins Act. Our decisions have been framed consistently with a view toward maintaining a stable, predictable policy of applying the monetary restraint needed to fight inflation and restore a stable, growing economy and a sound dollar internationally. The record over the last few years in achieving monetary growth objectives has been reasonably good. There has been



a general deceleration in monetary growth over the past few years. Growth of the narrow monetary aggregates in 1980 was within one quarter percentage point of the target range. Most importantly, we believe we have succeeded in imposing a crucial restraint on inflationary forces.



Action assigned Mr. Allison

ROBERT J. DOLE, KANS., CHAIRMAN

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GEORGE J. MITCHELL, MAINE

## United States Senate

COMMITTEE ON FINANCE

WASHINGTON, D.C. 20510

March 3, 1981

*7-66*

ROBERT E. LIGONIZER, CHIEF COUNSEL  
MICHAEL STERN, MINORITY STAFF DIRECTOR

Honorable Paul A. Volcker  
Chairman  
Federal Reserve Board  
Constitution Avenue between  
20th and 21st Streets  
Washington, D.C. 20551

Dear Mr. Volcker:

I am enclosing a copy of a letter I recently received from a constituent. Frankly, I am very concerned about some of the problems the First National Bank of Linn Creek, Camdenton is experiencing.

Would you please let me know whether anything can be done to alleviate these problems?

Sincerely,

  
John C. Danforth

Enclosure



# First National Bank

OF LINN CREEK, CAMDENTON  
P.O. BOX 157 / CAMDENTON, MISSOURI 65020

February 20, 1981

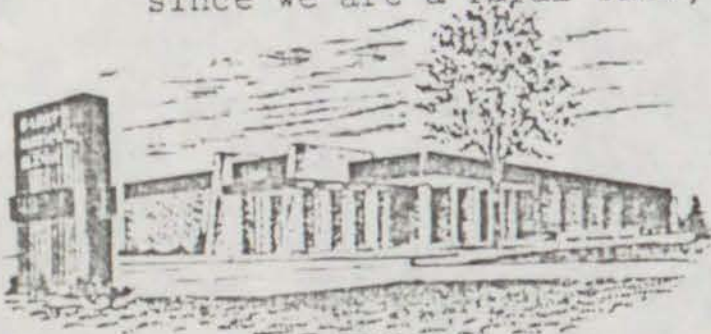
The Honorable John C. Danforth  
United States Senate  
Washington, D.C. 20510

Dear Senator Danforth,

I am writing you today regarding two issues. First of all I was quite impressed and very encouraged by President Reagan's economic address to the Congress which was televised on last Wednesday evening. I feel very strongly that now is the time for we, the American public, to realize that sacrifice is going to be necessary in all sectors of the country in order for our economic conditions to return to a stable condition. I am prepared to make any sacrifice necessary on my part and find that feeling to be prevalent with those friends and customers with whom I am in contact. I hope that you can take the same position of support for the President's proposals on this matter.

Secondly, you will recall that only a few months ago, law was enacted whereby all financial institutions came under the jurisdiction of the Federal Reserve System. We, as a National Bank, have been a member of Federal Reserve System all along. Our only reason for having that membership was due to the fact that it was compulsory as a National Bank Charter, which we did not choose to abandon. We have, however, been quite dis-satisfied with the service and the attitude of the Federal Reserve Bank in St. Louis. I regret to tell you that the attitude and services have deteriorated since the enactment of the new law which removed the fear of any further exodus of reserve members. There are a number of inequities for old members, i.e., we are being confronted with the new charges being phased in, inasmuch as we are still on a full reserve basis and expected to pay for the service fees now being implemented at the Fed while the new members are all on a long term phase-in program for service.

The issue that resulted in my writing to you developed this past week. We rarely ask for, and almost never get, any services or consideration from Fed. When we ask for used currency, we usually get new currency. This is an inconvenience that can be overlooked. Last week we asked for a certain denomination of new currency to accomodate our Automatic Teller Machine which is adjusted for new currency. Since this did not fall within the scope of their present internal rulings, we were denied. We were advised that we should call a service group in to re-adjust our machine. This could be done, but at considerable expense since we are a rural bank, not easily accessible to the people who service this



Main Office  
Phone (314) 346-3311

FDIC



and Osage Beach Branch  
Phone (314) 348-3171



# First National Bank

OF LINN CREEK, CAMDENTON  
P.O. BOX 157 / CAMDENTON, MISSOURI 65020

February 20, 1981

The Honorable John C. Danforth

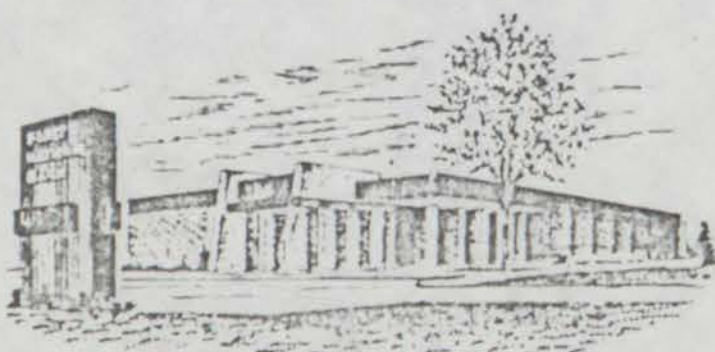
equipment. It should also be noted that frequent discrepancies occur in the count of used currency when dispensed from Automatic Teller Machines when the machines are adjusted for used currency. Fed has been sending us currency that we have to sort, the recent mutilated rate being about 40%, and it should also be noted that the quality of currency sent to us from Fed has been so poor we have to return a large portion of it to them as it should have been mutilated before it was sent to us. This may seem a rather insignificant matter to you in your office but it disturbs and distresses me greatly that we are required by Government regulations to keep substantial reserves in a Federal Reserve Bank and get absolutely no assistance or cooperation from them.

I would hope that you could share my view in this regard now and also when considering future federal regulatory authority.

Very truly yours,

*Richard Goins*  
Richard Goins  
President

RG:md



Main Office  
Phone (314) 346-3311

FDIC



and Osage Beach Branch  
Phone (314) 348-2171



*Action assigned Mr. Kichline*

W. HENSON MOORE  
6TH DISTRICT, LOUISIANA

COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEES:  
OVERSIGHT  
PUBLIC ASSISTANCE AND  
UNEMPLOYMENT COMPENSATION  
SELECT REVENUE MEASURES



Congress of the United States  
House of Representatives

Washington, D.C. 20515

March 4, 1981

WASHINGTON OFFICE:  
2404 RAYBURN HOUSE OFFICE BUILDING  
WASHINGTON, D.C. 20515  
(202) 225-3901

DISTRICT OFFICES:  
236 FEDERAL BUILDING  
750 FLORIDA STREET  
BATON ROUGE, LOUISIANA 70801  
(504) 344-7679

MOBILE OFFICE

HAMMOND TELEPHONE  
(504) 345-4929

Honorable Paul A. Volcker  
Chairman  
Federal Reserve System  
Federal Reserve Building  
Washington, D.C. 20551

Dear Mr. Chairman:

Consistent with our conversation at the Ways and Means Committee hearing of March 3, I am enclosing for your review legislation I have introduced to serve as a comprehensive yet cost-efficient means to encourage savings formation and address a series of social purposes as well. On February 24, Senator Chafee who serves as Chairman of the Senate Finance Committee's Subcommittee on Savings, Pensions and Investment Policy, began hearings on this measure which he has sponsored in the Senate.

Our "Savings and Retirement Income Incentive Act of 1981" will significantly increase savings for all income levels. It is a natural extension of present incentives for savings and action taken by the Senate Finance Committee late last year in its omnibus tax cut bill. It embraces desired objectives of only tested provisions, corrections of problems in existing provisions, significant incentives to increase savings, self-reliance in retirement income, first-time home ownership, new savings formation and vocational or college education for the account holder's children. It has won approval by more than 25 national organizations representing investment and financial communities, the nation's largest retirement organizations, and national military organizations which have helped in the almost one-year drafting effort.

Initial estimates put the static revenue cost at roughly \$3.5 billion in the first year with savings formation encouraged by its terms giving an early cost recovery. Econometric tests are underway. In view of recent surges in personal debt



Chairman Volcker  
March 4, 1981  
Page 2

growth, and record low rates of personal savings, it is extremely timely. It also only rewards retirement savings beyond activity already provided under mandatory employer-sponsored plans.

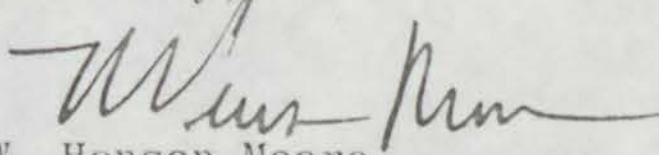
The bill greatly extends the utilization of Individual Retirement Accounts and makes them more flexible. For further explanation, please take a look at the enclosed statement I submitted with introduction of the bill on January 23 along with the endorsements or statements of support given it.

I have also enclosed a survey recently taken by Roger Seasonwein Associates, Inc. of New Rochell, New York, showing Americans would save more if given a tax incentive to do so that would beat inflation damage now done to savings. In summary, it finds half the nation's workforce is saving nothing for retirement and 44% say they will not be able to afford to retire. Other findings also merit your inspection.

I would appreciate receiving your comments on this measure and I await having the opportunity to review them.

With kindest personal regards, I remain

Sincerely,



W. Henson Moore  
Member of Congress

WHM:cuf

Enclosures



Action assigned Mr. Allison

WYCHE FOWLER, JR.  
5TH DISTRICT, GEORGIA

PLEASE RESPOND TO:

WASHINGTON OFFICE:  
1504 LONGWORTH HOUSE  
OFFICE BUILDING  
WASHINGTON, D.C. 20515  
(202) 225-3801

DISTRICT OFFICE  
SUITE 425, WILLIAM-OLIVER BUILDING  
32 PEACHTREE STREET  
ATLANTA, GEORGIA 30303  
(404) 688-8207

Congress of the United States

House of Representatives

Washington, D.C. 20515

March 23, 1981

COMMITTEE ON  
WAYS AND MEANS

SELECT COMMITTEE ON  
INTELLIGENCE

# 96

Honorable Paul A. Volcker  
Chairman  
Federal Reserve Board  
20th and C Streets, N.W.  
Washington, D.C. 20551

Dear Mr. Volcker:

I am writing on behalf of a constituent of mine regarding current restrictions placed on the circulation of \$500 and \$1,000 bills.

Apparently, an individual can not obtain a \$500 or \$1,000 bill due to existing regulations on these two denominations of paper currency. My constituent wanted to use a \$1,000 bill for a sales promotion and was unable to legally obtain a bill of this size. Is this regulation necessary? Since we are trying to reduce unnecessary regulations, I would appreciate your review of this restriction on the availability of \$500 and \$1,000 bills.

Thank you for your assistance regarding this matter.

Sincerely,

*Wyche Fowler*  
WYCHE FOWLER, JR.  
Member of Congress



BILL GREEN  
18TH DISTRICT, NEW YORK

COMMITTEE ON APPROPRIATIONS

SUBCOMMITTEES:  
HUD-INDEPENDENT AGENCIES  
DISTRICT OF COLUMBIA

Congress of the United States  
House of Representatives

Washington, D.C. 20515

March 25, 1981

WASHINGTON OFFICE:  
1417 LONGWORTH HOUSE OFFICE BUILDING  
WASHINGTON, D.C. 20515  
(202) 225-2436

NEW YORK OFFICE:  
GRAND CENTRAL POST OFFICE BUILDING  
110 EAST 45TH STREET  
NEW YORK, NEW YORK 10017  
(212) 826-4466

Honorable Paul A. Volcker  
Chairman  
Federal Reserve System  
20th & Constitution Avenue, N.W.  
Washington, D.C. 20551

Dear Paul:

I appreciate your taking the time to comment on my savings proposal in your letter of March 4, 1981.

I agree with you that a key issue in any program for a savings incentive, whether by tax relief or a direct subsidy, is whether it truly produces new savings, as opposed to simply shifting savings that would occur anyway into a savings program that is a beneficiary of the incentive. As you know from our telephone conversation some time ago on research regarding personal savings, that is why I am concerned at the lack of reliable research on United States personal savings habits.

My reasons for preferring a subsidy to a tax incentive approach have been as follows:

1. The West German experience seems very positive. I enclose two Congressional Research Service studies made at my request that document that. In addition, during the recent visit to Washington of Dr. Otto Graf Lambsdorff, the West German Minister of Economics, I had the opportunity to chat with him and he insisted that, to a considerable degree, the program had produced new savings and not just a shift into the program of savings that would have occurred in any event. He confirmed the CRS opinion that the program appeared to have effected a significant long term change in savings patterns in that a significant portion of savers continued their savings even after the subsidy had been paid.
2. A tax incentive appeals primarily to upper income taxpayers. Because such persons tend to save anyway, it appears that a tax incentive program is more likely to cause only a shift in savings forms than a low and moderate income savings subsidy program. There seems to be widespread agreement that the savings rider to the windfall profits tax generated little or no new savings - at considerable cost.
3. Furthermore, we need to target the modest income families where the marginal propensity to save is lower. The op-ed article in the Wall Street Journal of March 23, 1981 written by Michael Evans clearly shows the dissaving that has occurred in the \$15,000 and under family income category. My proposal targets these families.

BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
1981 MAR 27 AM 9:06  
RECEIVED  
OFFICE OF THE CHAIRMAN

103



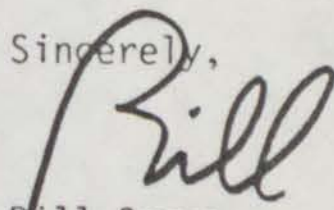
Honorable Paul A. Volcker  
March 25, 1981  
Page Two

4. A major advantage of my subsidy proposal over a tax program is that my program calls for no outlays for seven years, as opposed to a tax program, where the revenue loss is immediate. This is particularly important since it seems clear that for the next couple of years the Reagan economic program envisages significant federal deficits. Encouraging savings to avoid monetizing the deficits or crowding out private investment ought to be a part of that program, and a program where the cost of encouraging the savings does not have to be paid until the Reagan economic program can take effect seems useful.

I should certainly welcome any thoughts your staff or you may have as to how a savings subsidy program could be structured to minimize the possibility of simply shifting savings from an unsubsidized to a subsidized account.

I am also open to your suggestion regarding how to provide a savings vehicle that does not conflict with the DIDC's mandate to deregulate interest rates.

Sincerely,



Bill Green  
Member of Congress

BG:ad  
Enclosures (3)



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## Citation Information

**Document Type:** Newspaper article

**Number of Pages Removed:** 1

**Citations:** Evans, Michael K. "The Source of Personal Saving in the U.S." *Wall Street Journal*, March 23, 1981.





UNITED STATES SENATE  
WASHINGTON, D. C.

JOHN C. DANFORTH  
MISSOURI

March 27, 1981

Honorable Paul Volcker  
Chairman  
Federal Reserve Board  
Washington, D.C. 20551

Dear Mr. Chairman:

Recently, you received a letter from Bob Hardy of KMOX-Radio, St. Louis, asking you for an interview the week of May 11. KMOX is the largest and most successful station of the CBS network; its listening audience is of the highest caliber. I believe you would find the exchange interesting and enjoyable, and hope you will be able to fit this into your schedule.

Sincerely,

*John C. Danforth*  
John C. Danforth

BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
1981 APR -6 AM 9:16  
RECEIVED  
OFFICE OF THE CHAIRMAN

*Dear Hunter,  
I have your letter  
about KMOX in St. Louis.  
I haven't heard anything  
from them, but we are trying  
to work something out when I do.  
Sincerely,  
John C. Danforth*



Response will be prepared by CLO

ROBERT J. LAGOMARSINO  
19TH DISTRICT, CALIFORNIA

111 LONGWORTH BUILDING  
WASHINGTON, D.C. 20515  
202-225-3601

ASSISTANT REGIONAL WHIP  
FOREIGN POLICY TASK FORCE  
CHAIRMAN

Congress of the United States  
House of Representatives  
Washington, D.C. 20515

March 30, 1981

COMMITTEE ON  
FOREIGN AFFAIRS  
SUBCOMMITTEES:  
INTERNATIONAL ECONOMIC POLICY  
AND TRADE  
RANKING MINORITY MEMBER  
INTER-AMERICAN AFFAIRS

COMMITTEE ON  
INTERIOR AND INSULAR  
AFFAIRS  
SUBCOMMITTEES:  
PACIFIC AFFAIRS  
RANKING MINORITY MEMBER  
NATIONAL PARKS AND INSULAR AFFAIRS  
OVERSIGHT AND SPECIAL  
INVESTIGATIONS

117

BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM

1981 APR 13 AM 11:14

RECEIVED  
OFFICE OF THE CHAIRMAN  
Mr. Paul Volcker  
Chairman, Federal Reserve Board  
Washington, D.C.

Hear Mr. Chairman:

Enclosed is the self-explanatory letter from my  
constituent, Robert J. Broomfield, concerning Deferred  
Compensation Accounts. Your consideration of Mr. Broom-  
field's remarks, and your comment would be appreciated.

Thank you for your assistance.

Sincerely,

  
ROBERT J. LAGOMARSINO  
Member of Congress

RJL:vbr  
Encl.



Senator Lagomarsino  
2332 Rayburn House Office  
Washington D.C. 20015

Dear Senator:

Recently the Federal Reserve Board ruled that Deferred Compensation Accounts are considered "non personal" and would require that Savings and Loans set up reserves for them as required in Federal Reserve Regulation "D".

By keeping this reserve requirement in the regulation, Banks and Thrift institutions will not be competitive because of the necessity of putting cash in reserves.

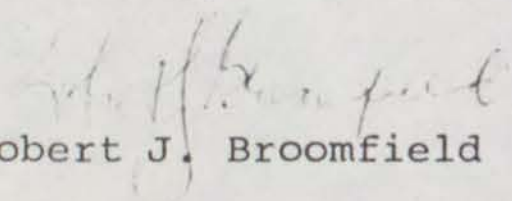
IRA and Keough accounts are considered a different category, yet the Deferred Compensation Accounts and the IRA and Keough accounts are all retirements accounts.

If the reserves are not removed, then the public will have been denied a greater retirement benefit and this is especially important today with the ever increasing cost of living.

Please send a letter to Paul Volcker, Chairman of the Federal Reserve and request strongly that they reconsider the reserve requirement.

Thank you for your help.

Sincerely,

  
Robert J. Broomfield



United States Senate

WASHINGTON, D.C. 20510

March 31, 1981

Mr. Paul A. Volcker  
Chairman of the Board of Governors  
of the Federal Reserve System  
Federal Reserve Building  
Constitution Avenue, N.W.  
Washington, D.C. 20551

Dear Mr. Volcker:

Enclosed you will find a copy of correspondence which I have received from Mr. Harry Z. Rosenberg concerning certain banking practices that he feels are irregular.

You will find the letter self-explanatory. Per a recent conversation between one of my aides and Mr. William Maloni, I would appreciate your checking into the matter for me and providing the information which will help me respond to my constituent further. I know that the matter will be carefully and objectively reviewed, and I am grateful for any assistance you will be able to render.

Sincerely,

*Paula*  
Paula Hawkins

PH/mps

Enclosure

Please respond to: P.O. Box 2000, Winter Park, FL 32790

9  
# 115  
RECEIVED  
OFFICE OF THE CHAIRMAN  
1981 APR -6 AM 9:12  
BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM



CARL LEVIN  
MICHIGAN

Action assigned Gil Schwartz

United States Senate

WASHINGTON, D.C. 20510

BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM

1981 APR -6 AM 9:11

RECEIVED  
OFFICE OF THE CHAIRMAN

April 1, 1981

#116

Paul Volcker  
Chairman  
Federal Reserve Board  
20 and C Sts. N.W.  
Washington, D.C. 20551

Dear Mr. Volcker:

Enclosed is a copy of a letter from Mr. Glen Harnden concerning the Monetary Control Act of 1980.

Mr. Harnden is concerned that the Monetary Control Act will allow the Federal Reserve Board to monetize the debts of private corporations, as well as State, Local and Foreign Governments. Mr. Harnden feels this will result in forcing the tax payers to absorb the losses that might occur.

I would like you to respond to the concerns expressed by Mr. Harnden. Please direct your response to Jim Callow (224-9118) of my Washington office.

Thank you for your cooperation and assistance. I look forward to your informative and timely reply.

Sincerely,

*Carl Levin*

Carl Levin

CL/jc



CHARLES H. PERCY, ILL., CHAIRMAN

Response will be prepared by CLO

HOWARD H. BAKER, JR., TENN.  
JESSE HELMS, N.C.  
S. I. HAYAKAWA, CALIF.  
RICHARD G. LUGAR, IND.  
CHARLES MC C. MATHIAS, JR., MD.  
NANCY L. KASSEBAUM, KANS.  
RUDY BOSCHWITZ, MINN.  
LARRY PRESSLER, S. DAK.

CLAIBORNE PELL, R.I.  
JOSEPH R. BIDEN, JR., DEL.  
JOHN GLENN, OHIO  
PAUL S. SARBANES, MD.  
EDWARD ZORINSKY, NEBR.  
PAUL E. TSONGAS, MASS.  
ALAN CRANSTON, CALIF.  
CHRISTOPHER J. DODD, CONN.

## United States Senate

COMMITTEE ON FOREIGN RELATIONS

WASHINGTON, D.C. 20510

April 3, 1981

BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
1981 APR 14 AM 10:55  
RECEIVED  
OFFICE OF THE CHAIRMAN

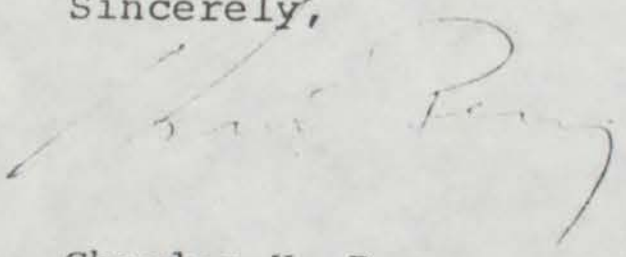
Mr. Paul A. Volcker  
Chairman  
Federal Reserve Board  
20th and Constitution Avenue, N.W.  
Washington, D.C. 20551

Dear Mr. Volcker:

I would appreciate receiving your comments on the enclosed article which appeared recently in the Chicago Sun-Times. I have received inquiries from concerned citizens who fear the Federal Reserve will be used to bail out insolvent foreign nations.

Thank you for your attention to this matter.

Sincerely,

  
Charles H. Percy  
Chairman

CHP:gmg

Enclosure



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## Citation Information

**Document Type:** Newspaper article

**Number of Pages Removed:** 1

**Citations:** LaMont, Douglas F. "Poor Nations Move Closer to Default on Huge Debt." *Chicago Sun-Times*, 1981.



FERNAND J. ST GERMAIN, R.I., CHAIRMAN  
HENRY S. REUSS, WIS.  
HENRY B. GONZALEZ, TEX.  
JOSEPH G. MINISH, N.J.  
FRANK ANNUNZIO, ILL.  
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ROBERT GARCIA, N.Y.  
MIKE LOWRY, WASH.  
CHARLES E. SCHUMER, N.Y.  
BARNEY FRANK, MASS.  
BILL PATMAN, TEX.  
WILLIAM J. COYNE, PA.

U.S. HOUSE OF REPRESENTATIVES  
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

NINETY-SEVENTH CONGRESS  
2129 RAYBURN HOUSE OFFICE BUILDING  
WASHINGTON, D.C. 20515

April 3, 1981

J. WILLIAM STANTON, OHIO  
CHALMERS P. WYLIE, OHIO  
STEWART B. MCKINNEY, CONN.  
GEORGE HANSEN, IDAHO  
HENRY J. HYDE, ILL.  
JIM LEACH, IOWA  
THOMAS B. EVANS, JR., DEL.  
RON PAUL, TEX.  
ED BETHUNE, ARK.  
NORMAN D. SHUMWAY, CALIF.  
JON HINSON, MISS.  
STAN PARRIS, VA.  
ED WEBER, OHIO  
BILL MCCOLLUM, FLA.  
GREGORY W. CARMAN, N.Y.  
GEORGE C. WORTLEY, N.Y.  
MARGE ROUKEMA, N.J.  
BILL LOWERY, CALIF.  
JAMES K. COYNE, PA.

225-4247

BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
1981 APR -6 AM 8:43  
RECEIVED  
OFFICE OF THE CHAIRMAN

The Honorable Paul Volcker  
Chairman  
Federal Reserve Board  
Washington, D. C. 20551

Dear Mr. Chairman:

I am concerned about your recent proposals put forward for public comment on the weekly money supply data. The reason for these proposals, as I understand it, is your concern about the inaccuracy of the weekly monetary data.

The inaccuracy of the weekly money supply data has been brought to the attention of the public in numerous hearings. It was precisely to help remedy this problem that I was told by experts inside and outside the Federal Reserve that the most important feature of the Depository Institutions Deregulation and Monetary Control Act of 1980 with respect to control of the money supply was the requirement that all depository institutions with checkable accounts regularly supply the Federal Reserve with monetary data.

A primary source of error in the money supply, defined to include currency, coin, and checking deposits of the public (called "M-1B"), has been the inability to obtain data from non-member banks on a weekly basis. Estimates of non-member bank deposits were obtained by the Federal Reserve in June and January of each year. These benchmark reports often caused large corrections in the monetary data. Now, under the Depository Institutions Deregulation and Monetary Control Act of 1980, this source of error is corrected.

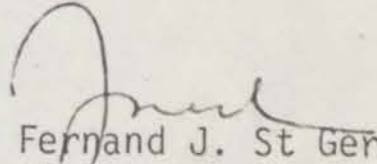
Therefore, it seems to me that you should be supplying much more accurate weekly estimates of M-1B. If this is not the case, I wish you would tell us why the claims for better monetary data made at the time of the hearings on the Monetary Control Act were incorrect. If exact data on the depository institutions transactions accounts are not available to the Federal Reserve, how is compliance with federal reserve requirements monitored?



Hon. Paul Volcker  
April 3, 1981  
Page 2

I fully understand the need for seasonally adjusted data. It is my understanding that the seasonal adjustment methods used by the Federal Reserve have been called into question by some experts who claim that it badly distorts the money supply data. I think that the Federal Reserve should improve its seasonal adjustment procedures if these criticisms are at all valid.

Sincerely,



Fernand J. St Germain  
Chairman





BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON, D. C. 20551

April 10, 1981

PAUL A. VOLCKER  
CHAIRMAN

The Honorable Stephen L. Neal  
House of Representatives  
Washington, D. C. 20515

Dear Steve:

As I mentioned to you briefly the other night, I was a little disturbed on reading your "additional views" in the Monetary Policy Report of the House Committee on Banking, Finance and Urban Affairs--not because I sensed any difference in fundamental approach to monetary policy but because your statement seemed to be based on certain technical misunderstandings of our announced targets for 1981. Obviously, I'd like to clear that up.

In the statement you indicate doubts that the 3-1/2 to 6 percent 1981 target range for adjusted M-1B represents "a reduction of one-half percent from the actual growth of adjusted M-1B in 1980," as you suggest that I stated. The one-half point reduction refers to a comparison of target growth ranges for 1980 and 1981. The 3-1/2 to 6 percent range for 1981 is by that amount lower than the comparable 4 to 6-1/2 percent range for 1980. Relative to the actual growth of adjusted M-1B in 1980, the growth range adopted for 1981 would entail a larger reduction. Last year, M-1B adjusted rose by 6-3/4 percent. Thus attainment of the target range adopted in 1981 would mean a slowing in growth of at least three-fourths of a percentage point if actual growth of adjusted M-1B this year is at the upper end of the target range and by two percentage points if the midpoint of the range is achieved.

The second and third enumerated points in your statement also appear to be based on technical misunderstandings. Your second point states that the Federal Reserve "arbitrarily increased its [meaning M-1B's] 1980 growth upward by one-half percentage point" by using an "artificially heightened base" for its adjusted M-1B target ranges for 1981.

It makes no real difference whether the 3-1/2 to 6 percent targeted growth range for M-1B is launched from the base of the actual observed series or from a series adjusted



to subtract previous shifts from interest-bearing assets into NOW/ATS accounts. Perhaps an example will make this clear. Suppose the level of observed M-1B in the base period were 1,500 and the M-1B level adjusted to exclude funds that had previously been shifted into NOW/ATS accounts from interest-bearing assets were 1,200. Suppose further that target growth for M-1B is set at 5 percent and this target rate represents growth adjusted to take out the effect of new shifts into NOW/ATS accounts from interest-bearing assets. The announced target for 1981 is based precisely on such a concept. This means that the growth rate of 5 percent as applied to the 1,500 level would yield a level at the end of the period of 1,575. That level reflects growth in M-1B during the period other than increases originating from new shifts from non-demand deposits and also perforce growth in all of the pre-existing NOW/ATS accounts.

Suppose, however, the 5 percent growth rate were taken from the lower level of 1,200, as you seem to imply it should. That would yield a level of 1,260 at the end of the period. But the pre-existing 300 of NOW/ATS accounts that had earlier been shifted from non-demand deposits still exist and indeed would have grown during the period. If their growth had been around 5 percent (yielding an increase of 15), then you can see that the 1,260 translates into, and is equivalent to, the earlier level of 1,575, because the difference is the 300 of pre-existing NOW/ATS accounts plus 15 in their growth. As you can see, the higher base level of 1,500 does not artificially inflate either the level or the growth rate of the adjusted M-1B series.

I am confused by your third point--not as a matter of arithmetic but of meaning. The target abstracting from shifts is 3-1/2 to 6 percent as you note in earlier parts of your statement. I believe that best represents the substance of what we are trying to achieve--that is, avoiding the distortions of institutional change. The higher range of 6 to 8-1/2 percent represents our estimate at this time of the actual behavior of M-1B, including the effect of shifts, that is consistent with the more meaningful target conceptually. If shifts are very large and/or more come from non-demand deposits than we had assumed, this range for actual M-1B growth would need to be adjusted upwards--and vice versa if shifts are smaller or less come from non-demand deposits. It is, in any event, substantially the same target as the "adjusted" 3-1/2 to 6 percent. If the adjusted target is disinflationary, so must be the unadjusted.



\* The Honorable Stephen L. Neal  
Page Three

Put another way, in the transition the public will re-adjust their asset holdings and shift funds from existing demand deposits and also from savings and other interest-bearing accounts into NOW/ATS accounts. Shifts into NOW/ATS accounts from non-demand will have the arithmetic effect of raising the observed growth rate during the year in M-1B. This occurred in 1980, and will probably occur to an even greater extent in 1981 as NOW and similar accounts are introduced nationwide at all depository institutions. But these shifts are of no real macro-economic significance, since they reflect a stock adjustment in the public's existing portfolio of money and near-monies in response to a structural change. Our target range for M-1B of 3-1/2 to 6 percent abstracts from such distortions by focusing on growth of adjusted M-1B--that is, adjusted to exclude the effects new shifts into NOW/ATS accounts from non-demand deposits. As noted earlier, that growth range entails a substantial decline in the rate of growth of adjusted M-1B this year relative to last. This is the significant economic measure of progress toward reduced monetary growth.

Finally, I should mention that, beginning with the March 13 H-6 money stock release, the Federal Reserve now publishes estimates of the magnitude and sources of shifts of funds into NOW/ATS accounts from demand and non-demand deposits. Consequently, those interested can track results on a monthly basis of an adjusted M-1B series.

I would be glad to get together and talk about this further at any time. These complexities can be a source of confusion, and detract from understanding what we are trying to achieve. I have the strongest interest in trying to be as clear and open as possible to minimize potential confusion.

Sincerely,

*Paul*

SHA:PAV:vcd

bcc: Mr. Axilrod  
Mrs. Mallardi (2) ✓





BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON, D. C. 20551

April 10, 1981

PAUL A. VOLCKER  
CHAIRMAN

The Honorable W. Henson Moore  
House of Representatives  
Washington, D.C. 20515

Dear Mr. Moore:

Thank you for your recent letter with which you enclosed a copy of H. R. 1250, the Savings and Retirement Income Incentive Act of 1981, and other related materials. I appreciate your asking me to comment on the proposed legislation.

Due at least in part to the interaction of the tax code with inflation, the current environment has created a serious problem of inadequate saving and capital formation which your bill seeks to address. The principal task before us in resolving this problem is to bring down inflation through appropriate budget and monetary policies. Within the limits imposed on revenue losses by the necessity to pursue a prudent fiscal policy, changing the tax system in ways that will increase incentives to save also could be helpful. Nevertheless, I have some concerns about particular features of your bill.

Although I would not question that the \$200 interest and dividend exclusion helps to promote saving by some of our households--perhaps particularly by certain lower-income households--I am concerned that much of the benefit of the exclusion goes to savers who already receive more than \$200 of interest and dividend income. Consequently, this proposal may not be efficient if the additions to the federal deficit are compared to the additional saving promoted.

I have indicated in the past that I am intrigued by the possibility of some expansion of Individual Retirement Accounts (IRA's) as a way to stimulate savings. However, I think it is very difficult to design an effective incentive. The opportunity to shelter part of income from tax will no doubt encourage some households to increase their total saving and place additional funds into IRA's while continuing to make the other investments planned before the tax change. Increasing the after-tax return to savings in IRA's may encourage more stable long-term financial planning and thrift than other savings incentives because the investment in an IRA is not subject to easy withdrawal. The magnitude of the aggregate savings response is difficult to determine because



The Honorable W. Henson Moore  
Page Two

some households may decide to channel the same funds into an IRA which they previously would have invested in some other way. That possibility increases to the extent the restrictions on withdrawal of funds from IRA's are relaxed.

In sum, while I also believe that we must increase savings, I have substantial doubts whether a \$200 interest and dividend exclusion is an effective way of doing so. My intuition is that some change in tax exempt retirement accounts may be promising. However, any judgment of the effectiveness of that approach would have to rely heavily on the amount of new savings generated relative to the tax revenues foregone. I simply do not have the information needed to make such a judgment.

Sincerely,

S/Paul A. Volcker

REM:FMS:JLK:pjt (#V-67)  
bcc: Messrs. Kichline, Struble, Mains  
Mrs. Mallardi (2)





BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON, D. C. 20551

April 10, 1981

PAUL A. VOLCKER  
CHAIRMAN

The Honorable Fernand J. St Germain  
Chairman  
Committee on Banking, Finance and  
Urban Affairs  
House of Representatives  
Washington, D. C. 20515

Dear Chairman St Germain:

I read your letter on the money supply data with concern. After all of the work you went through to help with passage of the Monetary Control Act, I can understand your reaction if you thought we were considering changes in frequency of publication because of inaccuracy in the data. However, I'm afraid there has been some misunderstanding. We tried to make clear our concern is not with any "inaccuracy" in the data but with the inherently volatile nature. The point is weekly changes may not be at all indicative of underlying trends, but the market reacts, and sometimes over-reacts, to them.

The fact is the data is better, in the sense of more complete and accurate, than before. In the early months of any new reporting system problems arise, but I believe they are very largely behind us.

So far as the seasonal adjustments are concerned, weekly seasonals of any series are notoriously difficult. We have devoted considerable effort over the years to improve ours, including long studies by outside experts. We are always working to improve the data, but the problem, to repeat, is the inherent volatility of the series even after removing seasonal influences.

I have no preconception that we should not continue to publish weekly, but in response to concerns by Senators Garn, Proxmire and others, as well as internally, we simply want to sample "consumer" opinion.

I am enclosing copies of my letter to the Senators and also (a recent report by outside experts we asked to review our seasonal adjustment procedures). I hope this clarifies matters. If it does not, I would be anxious to discuss the issue with you.

RS:PAV:vcd (#V-114)  
bcc: Mrs. Mallardi ✓  
Messrs. Axilrod, Ettin,  
Lindsey, Simpson

Sincerely,

*Paul*

Enclosures  
(3/24/81 ltr  
to Garn &  
Proxmire)

*P.S. I understand this is not yet in final form & I hope you will accept that caveat!*  
*PAV*



BENJAMIN S. ROSENTHAL, N.Y., CHAIRMAN

JOHN CONYERS, JR., MICH.  
EUGENE V. ATKINSON, PA.  
STEPHEN L. NEAL, N.C.  
DOUG BARNARD, JR., GA.  
PETER A. PEYSER, N.Y.

Action assigned Janet Hart

NINETY-SEVENTH CONGRESS

# Congress of the United States

## House of Representatives

COMMERCE, CONSUMER, AND MONETARY AFFAIRS  
SUBCOMMITTEE

OF THE  
COMMITTEE ON GOVERNMENT OPERATIONS

RAYBURN HOUSE OFFICE BUILDING, ROOM B-377  
WASHINGTON, D.C. 20515

April 13, 1981

LYLE WILLIAMS, OHIO  
HAL DAUB, NEBR.  
WILLIAM F. CLINGER, JR., PA.  
JOHN HILER, IND.

MAJORITY—(202) 225-4407

BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
1981 APR 15 AM 10:54  
RECEIVED  
OFFICE OF THE CHAIRMAN

Hon. Paul A. Volcker, Chairman  
Board of Governors  
Federal Reserve System  
Washington, D. C. 20551

Dear Mr. Chairman:

Under Section 171 of the Truth in Lending Act and Section 226.29 of the Federal Reserve's newly revised Regulation Z (effective April 1, 1981), the Federal Reserve Board is required to exempt from the requirements of the federal Truth in Lending Act certain types of consumer credit transactions in any individual state that applies for such an exemption, providing certain conditions are met. I am writing to inquire whether the state of Delaware has been granted such an exemption or has applied for such an exemption, or whether Board staff or any Board Governor has received any informal indication that Delaware intends to apply for a Truth-In-Lending exemption. I am also requesting a statement of the Board's general policy toward the granting of such exemptions.

If Delaware has applied for such an exemption, please supply to the subcommittee a copy of the complete application and copies of any accompanying correspondence, as well as copies of all correspondence from Board staff or members in connection with the exemption application.

If Delaware has not applied for an exemption, then please notify this subcommittee in writing if the Board receives such an application from Delaware at any time within the next two years, and supply the requested documents at that time.

With regard to the Board's general policies on the granting of state exemptions from Truth in Lending, please include in the requested policy statement a specific enumeration of the standards that must be met by a state in order to meet the statutory requirement for "adequate provision for enforcement" of the similar state requirements. In addition, please state whether the Board requires a state to have established clear authority and intention for state examiners to conduct on-site examinations of federally chartered financial institutions as necessary conditions for the granting of a Truth in Lending exemption.



If authority and intention to conduct on-site examinations of federally chartered institutions are not required by the Board as necessary conditions for an exemption, please explain how the Board believes that adequate enforcement can be assured if on-site examinations cannot or will not be conducted?

Sincerely,



Benjamin S. Rosenthal  
Chairman

BSR:tb



NORM D'AMOURS

1ST DISTRICT, NEW HAMPSHIRE

COMMITTEE ON  
BANKING, FINANCE  
AND URBAN AFFAIRS

MERCHANT MARINE AND  
FISHERIES COMMITTEE

CHAIRMAN:  
SUBCOMMITTEE ON OCEANOGRAPHY

WASHINGTON OFFICE:

2242 RAYBURN HOUSE OFFICE BUILDING  
WASHINGTON, D.C. 20515  
(202) 225-5456

Cong. Liaison Office will prepare response

Congress of the United States  
House of Representatives

Washington, D.C. 20515

April 15, 1981

DISTRICT OFFICES:  
MANCHESTER, NEW HAMPSHIRE 03105  
720 NORRIS COTTON FEDERAL BUILDING  
275 CHESTNUT STREET  
(603) 668-6800  
(603) 666-7526  
TOLL FREE: 1-800-562-3802  
PORTSMOUTH, NEW HAMPSHIRE 03801  
425 AND 426 FEDERAL BUILDING  
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(603) 436-7720, EXT. 707  
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128 FEDERAL BUILDING  
719 MAIN STREET  
(603) 524-7185

Honorable Paul Volcker  
Chairman  
Federal Reserve Board  
Constitution Avenue, N.W.  
Washington, D.C. 20551

Dear Chairman Volcker:

Thank you for your response of March 24th to my inquiry concerning the availability of NOW accounts to governmental units and other nonprofit groups. I am pleased to hear that the Board's staff has been asked to study NOW account eligibility criteria and prepare recommendations for the Board.

I am somewhat concerned by recurring reports that the Board's staff is considering a recommendation that certain groups which are now eligible for NOW accounts lose their eligibility. Such a recommendation would run completely contrary to the deregulation philosophy of the new administration and the intent of Public Law 96-221, the Depository Institutions Deregulation and Monetary Control Act of 1980.

I support your initiative to provide greater consistency among the categories of depositors eligible for NOW accounts. I firmly believe, however, that this objective must be met by expanding the types of eligible depositors, not by restricting the types of eligible depositors. In particular, I hope the Board will remove the arbitrary distinction which makes public educational groups (like school boards) eligible, but which makes other governmental units ineligible.

I stand ready to assist you in any way I can.

Sincerely,

*Norm D'Amours*  
Norman E. D'Amours  
Member of Congress

NED/mr

123  
RECEIVED  
OFFICE OF THE CHAIRMAN  
1981 APR 20 AM 9:04  
BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM



BILL MCCOLLUM

5TH DISTRICT, FLORIDA

COMMITTEE ON  
BANKING, FINANCE AND  
URBAN AFFAIRS  
COMMITTEE ON  
THE JUDICIARY  
BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE  
1981 APR 20 9 19 AM  
RECEIVED  
OFFICE OF THE CHAIRMAN

Cong. Liaison Office will prepare response  
**Congress of the United States**

**House of Representatives**

Washington, D.C. 20515

1313 LONGWORTH HOUSE OFFICE BUILDING  
WASHINGTON, D.C. 20515  
(202) 225-2176

DISTRICT OFFICES:

SUITE 345  
701 EAST ALTAMONTE DRIVE  
ALTAMONTE SPRINGS, FLORIDA 32701  
(305) 830-6655

SUITE 224  
5800 U.S. HIGHWAY 19 NORTH  
HOLIDAY, FLORIDA 33590  
(813) 937-4231

124  
#124  
April 16, 1981

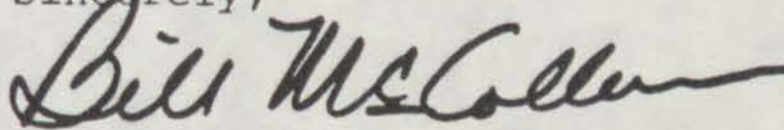
Honorable Paul Volcker  
Chairman Federal Reserve Board  
Washington, D.C. 20551

Dear Mr. Chairman:

Attached please find copies of two letters from constituents of mine concerning a provision of the Monetary Control Act. This provision amends Section 14 of the Federal Reserve Act to allow the Federal Reserve to buy in the market obligations of foreign governments or agencies.

Any assistance you could provide me in responding to the comments and concerns of these constituents would be deeply appreciated. Thank you for your time and attention to this matter.

Sincerely,



BILL MCCOLLUM  
Member of Congress

BMcC:lwf

Enclosures



To take our losses, Bank get 7 day  
notes properly without compensation,  
the Minute Rocky can bring enough  
Senators to approve Interdependent  
status (on world)

Flats, Wipe out the middle  
Class. Just loads of slaves.

Yours sincerely,  
Anthony Zula Jr



Dear Rep. McCain

I have just learned about a bill  
that the 1980 Congress passed that must be repealed.  
This bill grants to the private (Fed) Reserve  
Bank to Monopolize and let them control (anywhere  
in the world) <sup>without any 2% inflation</sup>  
This means that if a bankrupt small  
American business wants to borrow all it has  
to do is to ask a private bank (and without  
to the Fed Reserve & they could run the printing  
press. This means that they can say  
anything I think that this is a terrible plan.

One Washington City could ruin the money  
control the world's currency & also get money  
this way.

Remember the Fed. would not have to  
ask Congress for approval

Don't forget that the Fed. want to  
lower our std. of living & transfer much of our  
wealth to the world ones. So that they can make  
a one world state & us - No Constitution - but  
a socialist Soviet type of country (w/ property  
rights) Also Carter signed a UN Treaty  
that would permit the UN. overlord

Love

The Fed goes into effect June 1, 1981



April 15, 1981

The Honorable Robert J. Lagomarsino  
House of Representatives  
Washington, D.C. 20515

Dear Mr. Lagomarsino:

Thank you for your letter of March 30 enclosing correspondence you received from Mr. Robert J. Broomfield, asking that the Board consider the status of deferred compensation plan accounts under Regulation D--Reserve Requirements of Depository Institutions. Regulations of the Internal Revenue Service require that these accounts be maintained and controlled by employers, with no beneficial interest for the individual employees other than the rights normally accruing to a general creditor. Under Regulation D such accounts presently are regarded as nonpersonal time deposits and are subject to a 3 percent reserve requirement.

In response to requests such as yours, the Board has amended Regulation D, effective April 30, 1981, to treat nontransferable time deposits representing funds of deferred compensation plans established pursuant to Subtitle D of the Revenue Act of 1978 as personal time deposits exempt from reserve requirements. A copy of the press release and Federal Register notice of this action is enclosed.

I hope this information will be useful to you. Please let me know if I can be of further assistance.

Sincerely,

(Signed) Donald J. Winn

Donald J. Winn  
Assistant to the Board

Enclosure (p.r. dtd. 4/10/81)  
JA:AFC:pjt (#V-117)  
bcc: Mr. Alexander  
Mrs. Mallardi (2)



April 16, 1981

Mr. George Gary  
Route 8  
Hayward, Wisconsin 54843

Dear Mr. Gary:

Senator Proxmire has requested that we respond to you directly concerning your letter to him dated March 1, 1981. With your letter you enclosed copies of two teller's receipts for transactions conducted with The Peoples National Bank of Hayward. You note that although the phrase, "Automatic Transfer of Funds," appears on both receipts, according to your records neither transaction was a transfer of funds, and you request an explanation as to why the receipt contained this language.

It appears that the phrase, "Automatic Transfer of Funds" on the receipt copies, along with the additional designs and phrases, is an advertisement for a service the bank is offering. Our staff contacted The Peoples National Bank of Hayward and learned that the bank routinely prints these and similar advertisements and messages on its teller's receipts. Accordingly the phrase, "Automatic Transfer of Funds" seems to be unrelated to the transactions evidenced by the receipts.

I regret the confusion in this matter, and hope that this explanation is helpful to you. Please let me know if I can be of further assistance.

Sincerely,

151  
William R. Maloni  
Special Assistant to the Board

cc: Senator Proxmire  
TW:CO:pjt (#V-100)  
bcc: Mr. Winer  
Mr. Schwartz (C-75)  
G.C. Log (#124)  
Legal Records (2)  
Mrs. Mallardi ✓



*Reserve*  
**GOOD  
NEWS**



ASK US FOR  
MORE INFORMATION

**AUTOMATIC TRANSFER OF FUNDS**

FROM SAVINGS ACCOUNTS  
TO CHECKING ACCOUNTS

**THE PEOPLES NATIONAL BANK  
OF HAYWARD**

HAYWARD, WISCONSIN 54843

1991 MAR 13

11:21 AM E 381

© BANKERS SYSTEMS INC. 1978 ST. CLOUD MINN FORM ATSC R-2



March 1, 1981  
Senator W. Proxmire  
U.S. Senate (vision)  
New Senate Office Bldg.  
Washington, D.C.

#000337

Dear Senator:

Enclosed are  
two deposit receipts; however  
at the top it says "Automatic  
transfer of funds, etc."

On check of records, neither  
were a transfer of funds, how  
come banks can give a  
receipt like this?

Thank you.

Sincerely,  
George Gorn





BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON, D. C. 20551

April 23, 1981

PAUL A. VOLCKER  
CHAIRMAN

The Honorable Charles H. Percy  
Chairman  
Committee on Foreign Relations  
United States Senate  
Washington, D.C. 20510

Dear Chairman Percy:

Thank you for your letter of April 3 requesting comments on an article by Douglas Lamont appearing in the Chicago Sun Times. Under the Monetary Control Act of 1980, the Federal Reserve is authorized to purchase obligations of, or fully guaranteed by, foreign governments and their agencies. The legislative history of the Act indicates that Congress intended this authority to be used only in conjunction with the Federal Reserve's normal activities in the foreign exchange market.

In the course of foreign exchange operations, the Federal Reserve from time to time acquires balances in foreign currencies. Before passage of the Monetary Control Act, there was no convenient way in which foreign currencies held by the Federal Reserve could be invested to earn interest. As indicated by Senator Proxmire on the floor of the Senate on March 27, 1980, during the Senate's consideration of the Monetary Control Act, the purpose of this provision is "to provide a vehicle whereby such foreign currency holdings could be invested in obligations of foreign governments and thereby earn interest. This authority would be used only to purchase such obligations with foreign currencies balances acquired by the Federal Reserve in the normal course of business." (126 Cong. Rec. S 3168) In my testimony before the Senate Banking Committee on September 26, 1979, I indicated that the purpose of the provision was to add to the present list of assets currently eligible for purchase by the Federal Reserve short-term government securities so as to enable the Federal Reserve to invest its non-interest bearing foreign currencies in interest bearing obligations. (These earnings are ultimately paid over by the Federal Reserve to the U.S. Treasury.) It was never the intent of the Federal Reserve to use this provision to "bail out" foreign governments that may be in danger of defaulting on their debts. We believe it is clear that the authority is to be used only in conjunction with the Federal Reserve's normal foreign exchange operations.



The Honorable Charles H. Percy  
Page Two

With respect to purchasing foreign obligations of developing countries, the Federal Reserve has not purchased and has no plans to purchase obligations of developing countries, and does not consider the new provision of law as a basis for loans of the kind apparently envisaged by Mr. Lamont. As noted above, the Federal Reserve would only buy short-term liquid obligations of foreign governments with currency balances of those foreign countries acquired in connection with foreign exchange operations undertaken for other purposes in order to earn a return on what would otherwise be non-interest bearing currency holdings. As indicated in the Board's Annual Report, reciprocal currency arrangements exist with the following countries only: Austria, Belgium, Canada, Denmark, England, France, Germany, Italy, Japan, Mexico, the Netherlands, Norway, Sweden, and Switzerland.

I appreciate the opportunity to clear up any misunderstanding that may have resulted from the article you brought to our attention.

Sincerely,

S/Paul A. Volcker

GTS:pjt (#V-120)

bcc: Gil Schwartz

Mrs. Mallardi (2) ✓



RON PAUL  
22ND DISTRICT, TEXAS

Room 1234  
LONGWORTH HOUSE OFFICE BUILDING  
WASHINGTON, D.C. 20515  
(202) 225-5951

HOUSTON CONGRESSIONAL HOT LINE  
(713) 237-1550

LAKE JACKSON CONGRESSIONAL HOT LINE  
(713) 297-0202

COMMITTEE ON BANKING,  
FINANCE, AND URBAN AFFAIRS

Mr. Paul Volcker  
Chairman, Federal Reserve Board  
Washington, D.C.

Dear Mr. Volcker:

You are invited to a Members-only reception and dinner hosted by the Foundation for Rational Economics and Education, Inc., with which I am associated.

Tuesday, April 28th

Cocktails: 5:00 p.m.

Dinner: 6:00 p.m.

April 23, 1981

Loew's L'Enfant Plaza Hotel  
480 L'Enfant Plaza East, S.W.  
Washington, D.C. 20024

We will have the opportunity to discuss the role of gold in the monetary system with some of our outstanding economic thinkers:

Mr. Lewis Lehrman, President  
The Lehrman Institute

Dr. Arthur Laffer  
Professor of Economics  
University of Southern California

Dr. Murray Rothbard  
Professor of Economics  
New York Polytechnic

Dr. Roy Jastram  
Professor of Economics  
University of California at Berkeley

Dr. Hans Sennholz, Chairman  
Department of Economics  
Grove City College

Mr. Robert Bleiberg, Editor  
Barron's

Mr. Lehrman will discuss Where the Fed Has Gone Wrong, and Dr. Sennholz will talk about Inflation and Social Instability.

The next day, these men will participate in an all-day seminar in Room S-207 in the Capitol for Members and staff. The seminar topics are listed on an enclosed sheet.

It would be wonderful if you could put the dinner on your calendar. Your appointment secretary could call Pat Blackwell at 225-5951 to let us know if you are able to come.

Sincerely,

*Ron Paul*

Ron Paul  
Member of Congress

*Mr. Volcker - Lew Lehrman suggested you might like to introduce him.*  
*Ron*

RP/1r

*Called 5/12/81 - requesting*  
*denied @ 730w. Stanton & Pettys*

1110 NASA ROAD 1  
SUITE 100  
HOUSTON, TEXAS 77058  
(713) 486-8583

6711 BELFORT AVENUE, SUITE 307  
HOUSTON, TEXAS 77087  
(713) 226-4636

2116 THOMPSON HIGHWAY, SUITE 105  
RICHMOND, TEXAS 77469  
(713) 226-4568

101 OYSTER CREEK DRIVE  
LAKE JACKSON, TEXAS 77566  
(713) 297-3966

RECEIVED  
OFFICE OF THE CHAIRMAN  
APR 24 PM 12:03  
FEDERAL RESERVE SYSTEM  
BOARD OF GOVERNORS





BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON, D. C. 20551

April 28, 1981

PAUL A. VOLCKER  
CHAIRMAN

The Honorable Carl Levin  
United States Senate  
Washington, D. C. 20510

Dear Senator Levin:

Thank you for your letter of April 1 concerning the authority of the Federal Reserve to purchase securities. The original Federal Reserve Act, enacted in 1913, permitted the Federal Reserve to purchase various types of securities in the open market. At that time we were permitted to purchase U. S. Government and agency securities, bankers' acceptances, bills of exchange, and certain short-term State and local government securities. The purpose of this authority originally was to provide Reserve Banks with the opportunity to earn a return on their funds. There was never any indication that the authority was to be used to "monetize" the debts of private organizations and State and local governments, and I can assure you that we have no intention of doing so. Indeed, virtually all of our securities holdings consist of U. S. Government and agency obligations (\$124 billion) purchased in conjunction with open market operations and the course of issuing Federal Reserve notes.

The Monetary Control Act of 1980 (P.L. 96-221) did amend the open market authority of the Federal Reserve to permit us also to purchase obligations of foreign governments and their agencies. The legislative history of the Act indicates that Congress intended this authority to be used only in conjunction with the Federal Reserve's normal activities in the foreign exchange market.

In the course of foreign exchange operations, the Federal Reserve from time to time acquires balances in foreign currencies. Prior to the passage of the Monetary Control Act, there was no convenient way in which foreign currencies held by the Federal Reserve could be invested to earn interest. As indicated by Senator Proxmire on the floor of the Senate on March 27, 1980, during the Senate's consideration of the Monetary Control Act, the purpose of this provision is "to provide a vehicle whereby such foreign currency holdings could be invested in obligations of foreign governments and thereby earn interest. This



The Honorable Carl Levin  
Page Two

authority would be used only to purchase such obligations with foreign currencies balances acquired by the Federal Reserve in the normal course of business." (126 Cong. Rec. S 3168) In my testimony before the Senate Banking Committee on September 26, 1979, I indicated that the purpose of the provision was to add to the present list of assets, currently eligible for purchase by the Federal Reserve, short-term government securities so as to enable the Federal Reserve to invest its non-interest bearing foreign currencies in interest bearing obligations. (These earnings are ultimately paid over by the Federal Reserve to the U. S. Treasury.) It was never the intent of the Federal Reserve to use this provision to "bail out" foreign governments that may be in danger of defaulting on their debts. We believe it is clear that the authority is to be used only in conjunction with the Federal Reserve's normal foreign exchange operations.

With respect to purchasing foreign obligations of developing countries, the Federal Reserve has not purchased and has no plans to purchase obligations of developing countries. As noted above, the Federal Reserve would only buy short-term liquid obligations of foreign governments with currency balances of those foreign countries acquired in connection with foreign exchange operations in order to earn a return on what would otherwise be non-interest bearing currency holdings. As indicated in the Board's Annual Report, reciprocal currency arrangements exist with the following countries only: Austria, Belgium, Canada, Denmark, England, France, Germany, Italy, Japan, Mexico, the Netherlands, Norway, Sweden, and Switzerland.

I hope that this is helpful to you. Please let me know if I can be of further assistance.

Sincerely,

S/Paul A. Volcker

GTS:vcd (#V-116)

bcc: Gil Schwartz  
Mrs. Mallardi (2)





BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON, D. C. 20551

April 28, 1981

PAUL A. VOLCKER  
CHAIRMAN

The Honorable Bill McCollum  
House of Representatives  
Washington, D. C. 20515

Dear Mr. McCollum:

Thank you for your letter of April 16 requesting comment on correspondence you received from your constituents regarding a provision of the Monetary Control Act and the authority of the Federal Reserve to purchase securities.

The original Federal Reserve Act, enacted in 1913, permitted the Federal Reserve to purchase various types of securities in the open market. At that time we were permitted to purchase U. S. Government and agency securities, bankers' acceptances, bills of exchange, and certain short-term State and local government securities. The purpose of this authority originally was to provide Reserve Banks with the opportunity to earn a return on their funds. There was never any indication that the authority was to be used to "monetize" the debts of private organizations and State and local governments, and I can assure you that we have no intention of doing so. Indeed, virtually all of our securities holdings consist of U. S. Government and agency obligations (\$124 billion) purchased in conjunction with open market operations and the course of issuing Federal Reserve notes.

The Monetary Control Act of 1980 (P.L. 96-221) did amend the open market authority of the Federal Reserve to permit us also to purchase obligations of foreign governments and their agencies. The legislative history of the Act indicates that Congress intended this authority to be used only in conjunction with the Federal Reserve's normal activities in the foreign exchange market.

In the course of foreign exchange operations, the Federal Reserve from time to time acquires balances in foreign currencies. Before passage of the Monetary Control Act, there was no convenient way in which foreign currencies held by the Federal Reserve could be invested to earn interest. As indicated by Senator Proxmire on the floor of the Senate on March 27, 1980, during the Senate's consideration of the Monetary Control Act, the purpose of



The Honorable Bill McCollum  
Page Two

Section 105(b)(2) of the Act is "to provide a vehicle whereby such foreign currency holdings could be invested in obligations of foreign governments and thereby earn interest. This authority would be used only to purchase such obligations with foreign currencies balances acquired by the Federal Reserve in the normal course of business." (126 Cong. Rec. S 3168) In my testimony before the Senate Banking Committee on September 26, 1979, I indicated that the purpose of the provision was to add to the present list of assets, currently eligible for purchase by the Federal Reserve, short-term government securities so as to enable the Federal Reserve to invest its non-interest bearing foreign currencies in interest bearing obligations. (These earnings are ultimately paid over by the Federal Reserve to the U. S. Treasury.) It was never the intent of the Federal Reserve to use this provision to "bail out" corporations or foreign governments that may be in danger of defaulting on their debts. We believe it is clear that the authority is to be used only in conjunction with the Federal Reserve's normal foreign exchange operations.

With respect to purchasing foreign obligations of developing countries, the Federal Reserve has not purchased and has no plans to purchase obligations of developing countries. As noted above, the Federal Reserve would only buy short-term liquid obligations of foreign governments with currency balances of those foreign countries acquired in connection with our normal foreign exchange operations in order to earn a return on what would otherwise be non-interest bearing currency holdings. As indicated in the Board's Annual Report, reciprocal currency arrangements exist with the following countries only: Austria, Belgium, Canada, Denmark, England, France, Germany, Italy, Japan, Mexico, the Netherlands, Norway, Sweden, and Switzerland.

I appreciate the opportunity to clear up any misunderstanding on this issue.

Sincerely,

S/Paul A. Volcker

GTS:AFC:vcd (#V-124)

bcc: Gil Schwartz  
Mrs. Mallardi (2)



April 28, 1981

The Honorable Norman E. D'Amours  
House of Representatives  
Washington, D. C. 20515

Dear Mr. D'Amours:

Thank you for your letter of April 15 commenting on NOW account eligibility requirements. As mentioned in Donald Winn's letter to you of April 15, which apparently crossed in the mail with your letter, the Board of Governors has requested public comment on a proposed interpretation of Regulation Q (Interest on Deposits) concerning the classes of depositors that are eligible to maintain NOW accounts at member banks.

The Board appreciates receiving your comments and they will be made a part of the public record on the proposal. I can assure you that your views will be given careful consideration by the Board before it makes a final decision.

Sincerely,

S/Paul A. Volcker

CO:vcd (V-123)

bcc: Paula Rice (for distribution)  
Mrs. Mallardi (2)





BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON, D. C. 20551

April 29, 1981

PAUL A. VOLCKER  
CHAIRMAN

The Honorable Lee H. Hamilton  
Chairman  
Subcommittee on Economic Goals and  
Intergovernmental Policy  
Joint Economic Committee  
Washington, D. C. 20510

Dear Chairman Hamilton:

Thank you for your letter of March 25, regarding the need to cut down on unnecessary regulatory burdens on the housing industry and on home owners. You ask that the Board assist you in determining the costs to mortgage lending institutions--individually and in the aggregate, and on a per application or per loan basis--of compliance with the Real Estate Settlement Procedures Act (RESPA), the Home Mortgage Disclosure Act, and the Truth in Lending Act.

The Board shares your concern about unneeded regulations that increase the operating burdens of lending institutions and that add to the costs ultimately passed on to consumers. In 1978 we instituted a regulatory improvement program, on a Board-wide basis, to take account of the burden imposed by regulations. Under this program, our staff is directed to consider and to present the Board with recommendations, including non-regulatory alternatives wherever possible, to minimize regulatory burdens while achieving the intended purpose. In many cases, of course, statutory requirements are fairly explicit, and the Board does not have the flexibility to modify the requirements.

You may be interested in the enclosed regulatory analysis, which was prepared by the Board's staff in connection with the recently adopted revision of Regulation Z (Truth in Lending). As noted in the summary on page one, we believe that the major changes made by the Board will, on balance, produce net benefits by substantially reducing regulatory burden, without sacrificing important consumer protections. Although we cannot estimate accurately either the long-term savings or the short-term costs associated with changing to the new requirements, we believe that there will be cost savings to institutions that are subject to Truth in Lending.

I also enclose, with regard to the home mortgage disclosure requirements, the regulatory analysis that accompanied the Regulation C proposal published in February 1981. It starts on page 13



of the enclosed Federal Register material. You will note that pages two through five review some of the basic findings (including costs of compliance) of a study that was jointly conducted by the FHLBB and the FDIC in 1977 and published in 1979. (If you should want a copy of the full report--entitled "Analysis of the Home Mortgage Disclosure Act Data from Three Standard Metropolitan Statistical Areas"--it can be obtained from either of the two agencies.) The economic impact of the revised regulation, as proposed, is discussed beginning at page 8.

The Board will continue to give careful consideration to minimizing the cost and other burdens imposed by our regulations. I cannot be too encouraging, however, about the prospect of our being able to determine the exact compliance costs borne by lending institutions that are subject to the Federal Reserve's jurisdiction. The reason is that, in order to obtain such information, we would need to impose an added reporting burden on lending institutions. We are reluctant to do so. Unless an institution is already analyzing costs for its own purposes, the cost of providing such data could impose a significant additional expense on the institution. We would not expect any lender to incur such costs unless the lender independently determined that the information was otherwise useful to it.

To the extent that institutions have the information readily available, we may be able to obtain some data about on-going Truth in Lending costs under a limited survey that the Board is planning to conduct among selected financial institutions. The major focus of this survey, however, is on the collection of data about the costs and benefits of complying with Regulation E. Regulation E, one of the Board's newest regulations, implements the Electronic Fund Transfer Act, which has imposed a fair amount of compliance costs on institutions that offer electronic transfer services. Again, with regard to both Regulations E and Z, we will be asking only for information that banks can assemble easily.

You also ask that we determine the extent to which lending institutions are required under existing or proposed regulations to provide duplicative or similar information under RESPA and Truth in Lending. In drafting revised Regulation Z, we made a special effort to eliminate such duplicative requirements. Without going into a technical explanation, let me just mention that we were able to coordinate the timing requirements for RESPA and Truth in Lending disclosures. In addition, we have eliminated Regulation Z's requirement regarding the itemization of the amount



The Honorable Lee H. Hamilton  
Page Three

financed for creditors that provide good faith estimates under RESPA. Since much of the information is duplicative, the RESPA disclosures can substitute for the amount financed itemization. Similarly, we were able in drafting Regulation Z to avoid some duplication with regulations issued by other federal agencies (the regulations of the Federal Home Loan Bank Board and the Office of the Comptroller of the Currency, with respect to variable rate mortgages, for example).

In closing, let me assure you that we will continue to work at keeping regulatory burdens to a minimum, and to be sensitive to the need for avoiding unnecessary costs.

Sincerely,

S/Paul A. Volcker

Enclosures

DSS:DJW:vcd (#V-105)

bcc: Ms. Smith  
Mrs. Mallardi (2) ✓



April 30, 1981

The Honorable Benjamin S. Rosenthal  
Chairman  
Subcommittee on Commerce, Consumer, and  
Monetary Affairs  
Committee on Government Operations  
House of Representatives  
Washington, D. C. 20515

Dear Chairman Rosenthal:

Thank you for your April 13 letter asking whether Delaware has been granted an exemption from the Board's Regulation Z and what the Board's policy is on the granting of such exemptions.

Delaware has not applied for an exemption from the federal Truth in Lending law, and our staff has received no indication that it intends to do so. If it does apply, we will be happy to provide you with a copy of the application and related documents.

In determining whether a state has adequate provision for enforcement, so as to qualify for an exemption, the Board considers information about the funding and the number and qualifications of the personnel engaged in enforcement. We also look at the state's examination procedures and practices. If the state wishes its exemption to cover federally-chartered institutions, it must also reach an agreement with the appropriate federal agency to ensure adequate enforcement of state law as to those institutions. A state's showing of procedures for conducting on-site examinations of federally-chartered institutions would be one way of demonstrating that its law contains adequate provision for enforcement. The rules on obtaining exemptions, including a list of the documents necessary for a complete application, are set forth in the enclosed appendix to Regulation Z and in the accompanying explanatory material.

Please let me know if I can be of further assistance.

Sincerely,

S/Paul A. Volcker

Enclosures  
LCG:CO:vcd (#V-121)  
bcc: Ms. Goldfaden  
Mr. Garwood  
Mrs. Mallardi (2)



JAKE GARN, UTAH, CHAIRMAN

JOHN TOWER, TEX.	HARRISON A. WILLIAMS, JR., N.J.
JOHN HEINZ, PA.	WILLIAM PROXMIRE, WIS.
WILLIAM L. ARMSTRONG, COLO.	ALAN CRANSTON, CALIF.
RICHARD G. LUGAR, IND.	DONALD W. RIEGLE, JR., MICH.
ALFONSE M. D'AMATO, N.Y.	PAUL S. SARBANES, MD.
JOHN H. CHAFFEE, R.I.	CHRISTOPHER J. DODD, CONN.
HARRISON SCHMITT, N. MEX.	ALAN J. DIXON, ILL.

M. DANNY WALL, STAFF DIRECTOR  
HOWARD A. MENELL, MINORITY STAFF DIRECTOR AND COUNSEL

## United States Senate

COMMITTEE ON BANKING, HOUSING, AND  
URBAN AFFAIRS

WASHINGTON, D.C. 20510

1981 JAN 23 11 55

January 19, 1981

122

The Honorable Paul A. Volcker  
Chairman  
Board of Governors  
Federal Reserve Board  
Washington, D.C. 20551

Dear Mr. Chairman:

During the last year and a half the Federal Reserve has been basing its policy decisions on rates of growth of the monetary aggregates while permitting interest rates to fluctuate in a fairly broad range. Previously, since 1975, the Federal Reserve had set targets for growth of the monetary aggregates, but had permitted short-term interest rates to fluctuate only in a narrow range. While both approaches use the monetary aggregates as the principle guide to policy decisions, the current approach focuses much more attention on short-run changes in growth of the money stock. This is unfortunate since it is changes in money growth over a year or more rather than short-term fluctuation in money growth, that have a significant effect on the economy.

Despite repeated warnings from you, and other Federal Reserve Chairmen before you, money market participants follow the weekly changes in the monetary supply measures religiously. At times large weekly changes in the money supply have lead to large short-term changes in interest rates no doubt contribute to uncertainty, instability in the financial markets, and heightened inflationary expectations. We understand that this coming year the weekly M1-A and M1-B statistics are likely to be even more erratic and uncertain than in the past because of the implementation of various parts of the Depository Institutions Deregulation and Monetary Control Act -- especially because of nationwide NOW accounts, the imposition of universal reserves, and a significant increase in the amount and types of data that will be collected by the Board. Money market decisions based on such data could certainly add to an already uncertain financial atmosphere.

It is our understanding that the Board has considered the very preliminary nature of the weekly money supply data in the past and whether these data should continue to be published. We also understand that the Board has concluded that even though the data are subject to frequent and sometimes large revisions the Board feels that data should continue to be published because of the potential for a challenge under the Freedom of Information Act. For the reasons given below we think the Board should reconsider the issue of whether or not the weekly publication of



The Honorable Paul A. Volcker  
January 19, 1981  
Page Two

monetary data serves a useful purpose.

First, as indicated above the Board has often indicated publicly that the weekly data are highly uncertain and subject to large revisions and has cautioned observers not to rely on them. Nevertheless, "Fed watchers" continue to cling to the weekly data releases as if they were gospel. These preliminary data may be contributing to instability in interest rates.

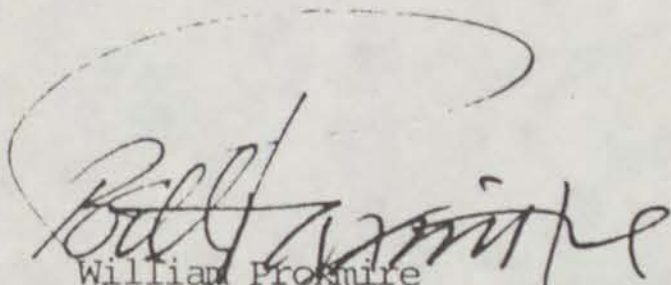
Second, the Board has for some time published M-2 and M-3 data only monthly, with a lag of several weeks, and this has not resulted in any adverse effects on financial markets. Given the possible increased uncertainty of the M1 measures due to changes caused by implementation of the Depository Institution Deregulation and Monetary Control Act it is not at all clear that the M1 measures should be relied upon in the near future as an indication of changes in the economy or Fed policy.

Third, it is our understanding that the Federal Reserve may be the only major central bank that issues weekly data. Most publish money stock data only monthly, and this does not seem to create any problem in their financial markets.

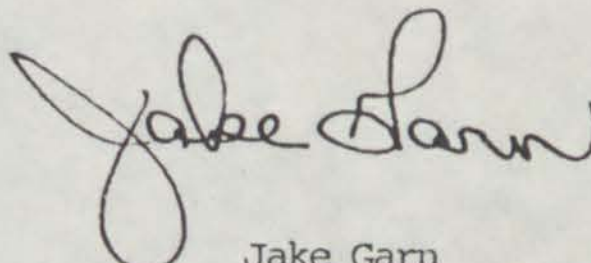
Fourth, it is highly unlikely that weekly economic data, either financial or non-financial, adds very much to our understanding of what is going on in the economy, and that even monthly data may contain a substantial amount of noise.

We would like to have the Board's view on this issue as soon as possible. In general we believe that anything that can be done to add some stability to our financial markets should be given serious thought. While our minds are open on this particular issue, the factors we have mentioned above suggest quite clearly that the weekly money supply data contribute little to our understanding of the underlying economy and that they may add to uncertainty and speculation in financial markets.

Sincerely,



William Proxmire  
U.S.S.



Jake Garn  
Chairman



March 24, 1981

The Honorable Manuel Lujan, Jr.  
House of Representatives  
Washington, D. C. 20515

Dear Mr. Lujan:

On behalf of the members of the Board, I want to thank you for your letters of March 18 expressing your support for the application of El Pueblo State Bank of Espanola, New Mexico, to become a one-bank holding company.

Your letters have been made a part of the record on this application, and I will be happy to advise you when the Board reaches a decision.

Sincerely,

(Signed) Donald J. Winn

Donald J. Winn  
Assistant to the Board

CO:vcd (V-89 & #162)

bcc: Sid Sussan  
Bill Sweet  
Sue Mitchell  
Mrs. Mallardi



Action assigned Mr. Kichline

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U.S. HOUSE OF REPRESENTATIVES  
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

NINETY-SEVENTH CONGRESS  
2129 RAYBURN HOUSE OFFICE BUILDING  
WASHINGTON, D.C. 20515

February 13, 1981

*Handwritten initials: JLB*

J. WILLIAM STANTON, OHIO  
CHALMERS P. WYLIE, OHIO  
STEWART B. MCKINNEY, CONN.  
GEORGE HANSEN, IDAHO  
HENRY J. HYDE, ILL.  
JIM LEACH, IOWA  
THOMAS B. EVANS, JR., DEL.  
RON PAUL, TEX.  
ED BETHUNE, ARK.  
NORMAN D. SHUMWAY, CALIF.  
JON HINSON, MISS.  
STAN FARRIS, VA.  
ED WEBER, OHIO  
BILL MCCOLLUM, FLA.  
GREGORY W. CARMAN, N.Y.  
GEORGE C. WORTLEY, N.Y.  
MARGE ROUKEMA, N.J.  
BILL LOWERY, CALIF.  
JAMES K. COYNE, PA.

225-4247

Honorable Paul Volcker  
Chairman, Board of Governors  
Federal Reserve System  
Washington, D.C. 20551

Dear Chairman Volcker:

I understand that the Federal Reserve has conducted a survey during February of short-term business lending rates below the prime rate. The information in this survey of approximately 340 banks is especially important in this period of crushing high interest rates.

I am most interested in receiving the results of that survey as rapidly as possible as I am now looking into the problems posed by advertising a prime rate which is not the lowest rate charged on short-term business loans.

Sincerely,

*Handwritten signature of Fernand J. St Germain*

Fernand J. St Germain  
Chairman

1981 FEB 11 11:30  
RECEIVED



March 25, 1981

The Honorable Jake Garn  
Chairman  
Committee on Banking, Housing  
and Urban Affairs  
United States Senate  
Washington, D. C. 20510

Dear Chairman Garn:

Thank you for your letter of March 16  
forwarding additional questions in connection with  
your Committee's hearing on February 25. I am  
pleased to enclose my responses to the questions.

Please let me know if I can be of further  
assistance.

Sincerely,

S/Paul A. Volcker

Enclosure

CO:vcd (#V-86)  
bcc: Mr. Prell  
Mr. Zeisel  
Mrs. Mallardi (2) ✓



CHAIRMAN VOLCKER'S RESPONSES TO WRITTEN QUESTIONS SUBMITTED BY  
CHAIRMAN GARN AS A FOLLOW-UP TO THE HEARING HELD BEFORE THE  
SENATE BANKING COMMITTEE ON FEBRUARY 25, 1981

- (1) The equation of exchange is perhaps best viewed as a mathematical identity defining the concept of velocity. In that sense it certainly is as correct today as it ever was. However, it can serve as a framework for policy only in the broadest terms.

As I have stressed on many occasions, the relationship of money to spending--that is, velocity--is a rather loose one, especially in the short run. The problem of defining money is a facet of this looseness. In the short run, velocity is quite variable and not fully predictable. And the same is true of the division of changes in nominal spending between gains in real output and inflation. This variability and unpredictability does argue for a cautious approach to monetary activism or fine-tuning.

In a longer run context, however, there are discernible trends to velocity that enable one to relate in a rough way the growth of money to the growth of nominal GNP. Moreover, over such long periods--several years in length--it is possible to define the trend of real GNP, particularly of potential output; given that reference point, one can relate the trend growth rate of money to the trend of inflation, at least to a useful approximation. It is this long-range connection between money and inflation that underlies the Federal Reserve's view that a moderation over time in monetary expansion is an essential part of the fight against inflation.



- (2) I believe that it is appropriate to focus major attention in the design of a tax cut package on the implications for capital formation. Higher levels of saving and investment are needed to improve productivity performance and thus pave the way for the reduction of production costs and for rising living standards. How to provide the maximum incentives for capital formation at the minimum cost in terms of lost federal revenues is a complex technical matter on which I cannot offer definitive answers. I am inclined to think that incentives for investment are likely to be the most cost-effective approach, with the investment essentially bringing forth the corresponding saving; however, there undoubtedly is some role for direct incentives to saving as well. Unfortunately, many of the proposals I've seen in this area appear likely to be rather inefficient. For example, the interest exemption legislated last year probably will provide little impetus for additional saving since many people already have interest income in excess of the exemption level. It is important that savings incentives be focused on encouraging additional saving--and particularly additional total saving, not just saving in one form that represents a substitution for other forms.



- (3) Thrift institutions are facing some significant difficulties today; "massive loan aid" would not, however, appear an imminent requirement. Even if credit assistance in some form were provided at some point, it is not at all clear that it would have an inflationary impact. If such assistance were provided through the Federal Reserve discount window, the impact on overall reserve availability could be offset through open market operations to keep monetary expansion within bounds. Credit assistance might be provided through other channels, of course, but I see no necessary reason for such an impact on inflation or interest rates.

The dangers in a major financial crisis tend generally to run in the direction of recession and deflation. The Federal Reserve, in its role as lender of last resort, would make every effort to prevent a liquidity crisis from arising as a result of anticipated or actual institutional failures. It is important, however, that we not exaggerate the dangers of such developments and undertake rash "bail out" actions on a broad scale. It might indeed be said that an excessive readiness through the years to bring forth a federal safety net when financial institutions or businesses have encountered difficulties has fostered a disdain for traditional rules of sound finance and has contributed indirectly to the inflationary process. Thus, while we cannot afford a cumulative financial disturbance, we must be willing to allow the market to exert a measure of discipline if we are to encourage the sort of financial and business practices that form the foundation of a stable economy.



- (4) Mr. Stockman has, I believe, revised his statement a bit. It is my understanding that he is not predicting a quick return to such low rates. In any event, there is an important and accurate element in Mr. Stockman's general view--namely, that a reduction in inflationary expectations is the key to a significant, sustained decline in interest rates.
- (5) The rapidity of financial innovation does remain a concern as we attempt to set appropriate targets for monetary expansion and then to achieve those targets. The impact of NOW accounts is a dramatic example, but, as you suggest, it is just one of many changes affecting the behavior of money. I don't think we can as a practical matter put an end to such innovation--nor would it be desirable. But I would wish that there was a more general appreciation of the need, in such an environment, for some flexibility in policy. I find it difficult to square the obvious fact of dramatic change in institutions and markets with the calls from many of our critics for more rigid approaches to monetary policy.



- (6) The movements of the narrow monetary aggregates have, as you say, been distorted recently by the introduction of NOW accounts on a nationwide basis. The growth of NOW balances has been somewhat faster than we expected before the year began, and the degree to which shifting from demand deposits has accounted for the inflow to NOWs has been a bit greater than expected.

The weekly M-1 numbers are extremely "noisy." Given the large random fluctuations they exhibit, I have always cautioned against placing great importance on any weekly change. We have examined the question of whether our publication policy should be changed, and are soliciting public comment on this issue at this time. Our thinking on this score was outlined in a recent letter to you, which I am submitting here for the record.

- (7) The issue of the discount rate is a complex one. It was examined in some detail in the recent staff study of the Federal Reserve's monetary policy operating procedures. I am uncomfortable about the "subsidy" problem; the use of surcharge on frequent borrowing by large banks has reduced the extent of the phenomenon, but it does not eliminate it. As I have indicated in Congressional testimony (and is discussed at length in the staff study), the concepts of a tied or penalty discount rate are not without their shortcomings. The Board is continuing to wrestle with this question in the hope of finding a solution that avoids unreasonable subsidies but does not at the same time introduce new difficulties in monetary control or unduly exacerbate short-run interest volatility.



- (8) Short- and long-term interest rates tend to fluctuate together (although the amplitude of fluctuation in long rates generally is smaller), but this need not be so over every particular time span. The broad movements in rates over the past year or so certainly have conformed to this pattern, and in recent weeks both short- and long-term security yields have dropped. Temporary departures from this pattern may reflect unusual supply conditions or other special factors.

It is true that long-term interest rates are still very high by historical standards, and this is an indication of prevailing concerns about the persistence of high rates of inflation. Lowering those expectations is certainly important to provide an environment more conducive to improved economic performance.

- (9) Loan commitments do constitute a potential call on the resources of a bank. Rising levels of unused commitments in effect represent a reduction in the liquidity of the banking system, all other things equal. By the same token, they represent a source of liquidity for the business firms holding the commitments. We at the Federal Reserve watch the loan commitment figures to gauge both the liquidity of the banks and the potential borrowing by businesses.



- (10) Unemployment is high by historical standards on average across the country, and especially high in some areas where there are concentrations of industries--such as automobile manufacture--that are experiencing particular difficulty. It is worth noting, however, that the proportion of the population employed is also at a high level. Structural changes in the work force have tended to push average unemployment rates above the norms of the past.

There clearly is a role in employment policy for well-designed programs to increase the mobility of labor and for action to remove the restraints on wage flexibility that inhibit hiring, particularly of lower skilled workers. What is most critical over the long run, however, is the adherence to anti-inflationary monetary and fiscal policy that will foster a stronger economy that is more competitive in world markets.

- (11) The Board has not undertaken any detailed studies of the regional impact of high interest rates. Certainly, there is the possibility of a differential impact, owing to relative concentrations of capital intensive industry or cyclically sensitive durable goods production. In the present instance, the cyclical problems experienced in the state of Michigan have been reinforced by difficulties associated with the failure of the U.S. manufacturers to gear their production of automobiles to models that are competitive in terms of price, quality, and fuel economy with foreign-made cars. It would be fair to say, however, that all areas of the country are sharing in the difficulties caused by the high interest rates that have been the result of inflation and the effort to contain it.